No. 2815

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

THE AMERICAN BANK OF ALASKA,
Plaintiff in Error,

vs.

G. JOHNSON, as trustee in bankruptcy in the matter of T. Mitchell & Co., a mining co-partnership consisting of Thomas Mitchell, Jas. J. Fallon and Herman Fawcett, bankrupts,
Defendant in Error.

BRIEF FOR PLAINTIFF IN ERROR.

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Filed this.....day of February, 1917.

FRANK D. MONCKTON, Clerk.

By.....Deputy Clerk.

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Statement of the Case.

This action was commenced by G. Johnson, asserting himself to be *trustee* for the creditors of T. Mitchell & Co., alleged bankrupts, against the American Bank of Alaska, a banking corporation, to recover the sum of $3,750.20, alleged to be the value of certain gold dust sold and delivered on July 31, 1913, to the bank by the alleged bankrupts the value thereof to be deposited to their credit, in their general account with said bank, within four

months of the time said copartnership is alleged to have been adjudicated bankrupt. The bank's officers then were C. J. Hurley, president and manager, A. Bruning, cashier, Paul Hopkins, gold dust teller, and Paul A. Rettig, teller.

The copartnership of T. Mitchell & Co. was a mining copartnership, consisting of three members, James J. Fallon, Thomas Mitchell, and Herman Fawcett, formed about the 18th of January, 1913, at which time said copartnership took an 85-per cent lease or lay on the Hoffman Bench placer mining claim on Ester Creek, Fairbanks Recording District, Fourth Judicial District, Alaska (Tr. p. 50). Fallon had charge of the clerical work, kept the books, drew checks, purchased supplies, etc., while the others did other mining work. They commenced actual mining operations June 9, 1913 (Tr. p. 53). Fallon was the only member of the firm that then had any money (Tr. p. 54) and he put up about $1,500.00 to start operations (Tr. pp. 50-51), and he also owned some mining property (Tr. p. 51), worth about $1,500.00 (Tr. p. 52). An account was opened with the defendant bank on June 11, 1913, under the partnership name of *"Mitchell & Co."* (Tr. pp. 77, and 166a, 166b) with a deposit of $200.00, and an additional deposit of $100.00 was made on June 19, 1913, and checks were drawn against the account until it was exhausted. On the 28th of June, 1913, the overdraft at the bank was $6.90 (Tr. p. 131), and under permission from the bank additional checks were drawn until the first cleanup, which

cleanup was sold to the bank and deposited to the credit of the firm on the 3rd of July, 1913, the value of said cleanup being $1,904.75 (Tr. pp. 54, 73, 130). Said cleanup was deposited and credited against the overdraft that had been growing steadily since June 28, and left an overdraft in the sum of $155.14 (Tr. p. 130). By July 7th, the overdraft had again increased to $795.46, at which time Mitchell & Co. executed a note to the bank in the sum of $850.00, which amount was credited to their account and left them at the close of the day a credit of $18.54 (Tr. pp. 131, 166a).

The second cleanup was delivered to the bank on the 16th of July, prior to which the overdraft had mounted to $133.71 (Tr. p. 132). The amount of the cleanup was $2,213.14 (Tr. pp. 73, 132). On the 18th of July the overdraft had mounted to $527.69, and on the 19th of July the firm gave another note to the bank in the sum of $500.00 (Tr. p. 133), and at the end of the same day the overdraft had increased to $599.44 (Tr. p. 133). Mitchell & Co. were permitted to continue to overdraw as before until the next cleanup, and on the 30th of July the overdraft amounted to $2,246.14 (Tr. pp. 133-166b). On the 31st of July the third cleanup was delivered to the bank, the amount thereof being the sum of $3,734.12, and an additional credit was allowed Mitchell & Co. in the sum of $16.15, making a total of $3,750.27, proceeds of said cleanup (Tr. p. 74).

At the time the third cleanup ws delivered to the bank, T. Mitchell & Co. was indebted to the bank as follows (Tr. p. 141):

Overdraft	$2,246.14
Promissory note credited June 8, 1913	850.00
Promissory note credited July 19, 1913	500.00

and another note the exact amount of which does not appear, but which was in excess of $160.00, presumably a note for $200.00 deposited June 11, 1913, as shown in bank book (Tr. p. 77).

> (MEMO. The first item of deposit of $400.00, as shown in Defendant's Exhibit 1, Transcript p. 77, is error, as it should be but $200.00, as shown by the footings and the Plaintiff's Exhibit M, Transcript p. 166a.)

Mitchell & Co. were therefore on the 31st of July, 1913, indebted to the bank on demand notes and overdraft in a sum in excess of $3,750.27 (Tr. p. 141).

The gold dust was sold to the bank in the same manner (Tr. p. 74) that had been followed with the two previous cleanups (Tr. p. 135), was delivered to the gold dust teller, who cleaned and weighed the same, and immediately thereafter delivered to the cashier, the credit memorandum showing amount of gold dust and the value thereof at the agreed price thereof (Tr. pp. 110-112). The cashier thereafter immediately made out a charge memorandum for the bookkeeper, charging against the account of T. Mitchell & Co. the amount of the $500.00 note (Tr. p. 75), and the $850.00 note, and

applying the balance of the proceeds of said gold dust, to wit, the sum of $154.13, as a credit on the smaller note then in the possession of the bank (Tr. p. 128). The bank closed at 3 p. m., but as is the custom in Fairbanks during the sluicing season, gold dust is received at any hour that any of the employees are in the bank. The books are closed at 3 p. m. and any deposits received, or charges made, or checks cashed, are then entered but entered on the books and records as a part of the next day's business (Tr. pp. 113-114). The gold dust was received at about 5 p. m. or a little later on July 31, 1913, and was cleaned, weighed, the value ascertained, the charge and credit slips were then made and filled out and placed in the bookkeeper's files for the attention of the bookkeeper on the next day, all before 6 p. m. on the 31st day of July (Tr. pp. 121, 146), although because these matters occurred after 3 p. m. on the 31st of July, the actual entries of these transactions by the bookkeeper in the individual ledger were not made until the next day and were then made under the date of August 1, 1913 (Tr. pp. 121, 169).

The note for $500.00 under date of July 19, 1913, was the personal note of Mr. Bruning, cashier of the bank, and a personal friend of Fallon's, proceeds of which were deposited to credit of T. Mitchell & Co. to take up their overdraft and to help them out until the next cleanup (Tr. 133) and the cashier's memo for the bookkeeper shows

that $500.00 was a refund to Mr. Bruning for the cash advanced by him.

All of the moneys represented by the original deposits, the notes, and overdrafts, went to pay laborers and other creditors (Tr. p. 67), who are now represented by the trustee and who seek to recover from the bank the amount received by the bank to repay it for such advancements, the benefits of which had already been received by the creditors. It was upon the representation that this cleanup would come to the bank that the bank had honored the checks and allowed the overdrafts (Tr. p. 150).

Between 8 p. m. and 9 p. m. on the 31st of July a garnishment was served on the bank in an action instituted by Rutherford and Widman against T. Mitchell & Co. (Tr. p. 120). The garnishment was served several hours after the credit and charge memos were prepared and placed in the book-keeper's files for entry by him on the next day (Tr. p. 121). After the service of the garnishment, the bank made answer that there was nothing to the credit of T. Mitchell & Co. (Tr. pp. 93-94) and thereafter refused to honor any further checks or permit any further overdraft, balanced up their bank book and returned same to them.

Mitchell & Co. did not consider themselves insolvent (Tr. pp. 82-83) and fully expected to continue their work, as they considered the lay valuable and that it would pay out. The ground was looking better (Tr. p. 83), and if the suit had not been started by Rutherford & Widman, thus precluding

them from securing further credit, they would have continued mining operations. Fallon indignantly denies he ever said they would or intended to shut down (Tr. p. 171). The bank did not decide to honor no more checks and not permit any overdrafts until the garnishment was served (Tr. pp. 152-153) and they then for the first time learned the financial condition of the firm. The bank had no intimation of the intention of Rutherford & Widman to institute suit. The bank made the application of the proceeds of the gold dust immediately upon ascertaining the value thereof and notified Mitchell & Co. before 6 p. m. that there was nothing to their credit (Tr. p. 101), when asked if anything could be garnisheed. The gold dust was purchased outright at a fixed valuation, to wit, at $16.40 per oz., and was not taken subject to assay. An advance of $3734.12 was made to their credit as soon as the dust was received, and when blown, cleaned and weighed, the additional credit of $16.15 was given them. Later, and on August 16, 1913, 2.55 oz. of gold was recovered from the black sand from the workings of Mitchell & Co., and the value thereof, $49.00 was credited to them and charged against the balance due on their notes. The item of black sand is not, however, included in this suit and may be disregarded.

This third cleanup was not treated by the bank any differently from the first two cleanups (Tr. pp. 63, 74) and all entries were made in the usual manner and in the due course of business of the

bank. The officers of the bank balanced up the bank book and returned same with canceled checks and note of $850.00 charged against the account, to Mr. Fallon, and notified him that they could not carry him any further (Tr. p. 83), and returned to Bruning his note for $500, proceeds of which had been deposited to credit of Mitchell & Co. (Tr. p. 75). The gold dust was delivered and sold to the bank in the regular course of business, in the *same* way the first and second cleanups were, and there is no pretense of fraud or collusion.

On August 23, 1913, five of the creditors of T. Mitchell & Co. filed in the District Court for the Fourth Division of Alaska a petition in involuntary bankruptcy asking that Fallon, Fawcett and Mitchell, "as copartners under the firm name and style of T. Mitchell & Co., may be adjudged by the Court to be bankrupts, within the purview of said acts" (Tr. pp. 21-24). Petitioners allege that they are creditors of said "T. Mitchell, J. J. Fallon and Herman Fawcett, copartners under the firm name and style of T. Mitchell & Co." (Tr. p. 22). They further allege that the said "T. Mitchell, J. J. Fallon, and Herman Fawcett, and as such firm of T. Mitchell & Co., are insolvent" (Tr. p. 23), "and that within four months next preceding the date of this petition the said T. Mitchell, J. J. Fallon, and Herman Fawcett, as such firm of T. Mitchell & Co., and individually, committed an act of bankruptcy", etc. (Tr. p. 23), by admitting in writing their inability individually and as a partnership to pay

their debts and expenses, and willingness to be adjudged bankrupts, etc. (Tr. p. 23), and to the petition is appended a communication to that effect, signed by the copartnership as such and by each partner as an individual (Tr. p. 25).

On September 26, 1913, an instrument was filed in said cause, purporting to be schedules in bankruptcy, entitled "In the matter of T. Mitchell & Co., a mining copartnership composed of Thomas Mitchell, James J. Fallon, and Herman Fawcett, bankrupts" (Tr. pp. 28-29). Each schedule is signed "Thomas Mitchell, Herman Fawcett, James J. Fallon, debtors", and has no other signatures of any description. Schedule A-3 (Tr. p. 30) refers to the claim of the plaintiff in error and gives the amount thereof as $345.87, stating that it was for "cash advanced for the mining partnership of T. Mitchell & Co." (Tr. p. 30). This item is followed by a note explaining the application of the proceeds of the gold dust derived from the third cleanup against overdue notes and overdraft, and after alleging the indebtedness to the bank in the sum of $4095.87 on the 31st of July, 1913, and the taking of the gold dust to the bank on the 31st of July, 1913, states: "and that said bank applied said sum of $3750.27 in payment of their indebtedness as above stated; but did not place the same to the credit of said bankrupts so that said bankrupts could check against the same, and that said bankrupts were not permitted to check against any part of said sum of $3750.27" (Tr. pp. 30, 31). At the end of

Schedule A Mitchell, Fawcett and Fallon swear to the schedule "as members of the mining copartnership of T. Mitchell & Co." and "declare the said schedule to be a statement of all the partnership debts of T. Mitchell & Co.", etc. (Tr. p. 32). Schedule B-1 contains a statement that the partnership owns no real estate and then gives a description of some mining property owned by James J. Fallon, as individual, of the value of $1,000 (Tr. pp. 32-33). In Schedule B-2 is listed certain personal property of T. Mitchell & Co., on Ester Creek, under attachment in the said case of Rutherford et al. v. T. Mitchell & Co., of the estimated value of $1886. Under subdivision 'm' of said schedule they allege that debtors have no personal property of any description "except as above stated" (Tr. pp. 33-34). Then follows a note as follows: "Said firm of T. Mitchell & Co. deposited with the American Bank of Alaska on the 31st day of July, 1913, gold dust mined from said Hoffman Fraction to the value of $3750.27, which gold dust was by the bank applied to the indebtedness then past due from said T. Mitchell & Co., which indebtedness consisted of $1350 in promissory notes and $2745.87 in an overdraft; but no part of the proceeds of said gold dust was by said bank placed on deposit for said T. Mitchell & Co., and was at no time subject to be checked against by said T. Mitchell & Co." (Tr. p. 34). In *no place* in the schedules is it alleged that there is *any claim against the bank, or that the bank has in its possession* any property of the

bankrupts, whoever they may be, and *said gold dust is not listed* as an asset at any place in the schedules or recapitulation.

On the 30th of September, 1913, an *alleged* adjudication in bankruptcy was signed by the Court, entitled, "In the Matter of T. Mitchell & Co., a Mining copartnership composed of Thomas Mitchell, James J. Fallon and Herman Fawcett, Bankrupts" (Tr. 39 and 40), and which reads as follows:

> "At Fairbanks, in said Division, on the 30th day of September, A. D. 1913, before the Honorable Frederic E. Fuller, judge of the said Court in bankruptcy, the petition of James G. McCann and others that Thomas Mitchell, James J. Fallon, and Herman Fawcett, copartners under the firm name of T. Mitchell & Co., be adjudged bankrupts, within the true intent and meaning of the acts of Congress relating to bankruptcy, having been heard and duly considered, the said Thomas Mitchell, James J. Fallon, and Herman Fawcett, copartners doing business under the firm name and style of 'T. Mitchell & Co.', are hereby declared and adjudged bankrupt accordingly.
>
> "Done in open Court this 30th day of September, A. D. 1913.
>
> "F. E. Fuller, District Judge"
>
> (Tr. pp. 39-40).

On the same day an instrument designated as an "order of reference" was signed by the Court, entitled "In the Matter of T. Mitchell & Co., a mining copartnership composed of Thomas Mitchell, James J. Fallon, and Herman Fawcett, Bankrupts", and which reads as follows:

"Whereas, Thomas Mitchell, James J. Fallon and Herman Fawcett, copartners under the firm name and style of T. Mitchell & Co., of the Fairbanks Precinct, Fourth Judicial Division, Territory of Alaska, on the 30th day of September, A. D. 1913, were duly adjudged bankrupts upon a petition filed in this Court against them on the 25th day of August, 1913, according to the provisions of the Acts of Congress relating to bankruptcy; it is, therefore,

Ordered that said matter be referred to W. H. Adams, referee in bankruptcy of this Court to take such further proceedings therein as are required by said acts and that the said Thomas Mitchell, James J. Fallon and Herman Fawcett shall attend before said Referee on the 16th day of October, 1913, at Fairbanks, Alaska, and thenceforth shall submit to such orders as may be made by said Referee or by this Court relating to said Bankruptcy.

Done in open Court this 30th day of September, A. D. 1913.

F. E. Fuller, District Judge"

(Tr. pp. 40-41).

Thereafter, and on the 16th day of October, 1913, W. H. Adams, referee in bankruptcy, signed an instrument purporting to be an "appointment of trustee by referee", entitled as follows: "In the Matter of T. Mitchell & Co., Bankrupts", and which reads as follows:

"At Fairbanks in said district on the 16th day of October, A. D. 1913, before W. H. Adams, referee in bankruptcy,

This being the day appointed by the Court, for the first meeting of creditors under the said bankruptcy, and of which due notice has been given in the Fairbanks Daily Times, a newspaper of general circulation published in said

district, I, the undersigned referee of the said Court in bankruptcy, sat at said time and place above mentioned, pursuant to such notice, to take the proof of debts, and for the choosing of a trustee, under the said bankruptcy.

And I do hereby certify that the creditors whose claims had been allowed, and who were present duly represented, failed to make choice of trustee of said bankrupt estate,

And, therefore, I do hereby appoint G. F. Johnson, of the Fairbanks Precinct, Fourth Judicial Division, Territory of Alaska, as trustee of the same; and the creditors being then and there present whose claims had been allowed, agreed that the bond of such trustee be fixed in the sum of One Thousand Dollars, which said sum of One Thousand Dollars is hereby fixed as the bond to be given by such trustee herein.

W. H. Adams,
Referee in Bankruptcy.

(Tr. pp. 45-46).

On the same day apparently, G. F. Johnson signed a purported notice of acceptance, entitled and reading as follows:

"In the Matter of T. Mitchell & Co., Bankrupts.—In Bankruptcy.—

Notice of acceptance by trustee.

To W. H. Adams, referee in bankruptcy on said Court:

You are hereby notified that I do hereby accept the office of Trustee in the above entitled matter.

Dated: At Fairbanks, Alaska, October 16, 1913.

G. F. Johnson"

(Tr. p. 45).

On the same day said Johnson filed what purported to be a bond of trustee "In the Matter of T. Mitchell & Co., Bankrupts", wherein, as a recital of the condition of the bond appears the following:

> "Whereas, the above named G. F. Johnson was, on the 16th day of October, A. D. 1913, appointed trustee in the case pending in bankruptcy in said Court, wherein Thomas Mitchell, James J. Fallon and Herman Fawcett are the bankrupts, and, he, the said G. F. Johnson has accepted said trust and all the duties and obligations pertaining thereto.
>
> Now, therefore, if the said G. F. Johnson, trustee as aforesaid, shall obey such orders as said Court may make in relation to said trust, and shall faithfully and truly account for all the moneys, assets and effects of the estate of said bankrupts which shall come into his hands and possession, and shall in all respects faithfully perform all his official duties as such trustee, then this obligation to be void; otherwise to remain in full force and virtue" (Tr. pp. 47-48).

On October 17, 1913, the referee in bankruptcy signed an order entitled "In the Matter of T. Mitchell & Co., Bankrupts", which purports to be an order approving bond of trustee and which reads as follows:

> "It appearing to the Court that G. F. Johnson of Fairbanks Precinct in said District has been duly appointed trustee of the estate of the above named bankrupt and has given a bond with sureties for the faithful performance of his official duties, in the amount fixed by the Court and consented to by the creditors to wit: in the sum of One Thousand Dollars,

it is ordered that the said bond be, and the same is hereby approved.

Dated Fairbanks, Alaska, October 17, 1913.

W. H. Adams,
Referee in Bankruptcy.

(Tr. pp. 46-47).

The Pleadings.

Thereafter this action was instituted and the defendant interposed a *demurrer* to the plaintiff's complaint, which was sustained, and on the 18th of June, 1914, an amended complaint was filed (Tr. pp. 4-7), to which defendant interposed a *general demurrer* (Tr. p. 10), which demurrer was overruled (Tr. p. 11), and thereafter an answer to the complaint (Tr. pp. 11-15), and a supplemental answer were filed (Tr. p. 16); plaintiff then filed a reply (Tr. pp. 17-18).

The *pleadings,* with the various paragraphs of the amended complaint, the answer and supplemental answer thereto, and the reply to the affirmative matter in the complaint, so grouped as to be readily understood, are as follows:

Amended Complaint:

Comes now the plaintiff above named, and, by leave of Court first had and obtained, files this, his amended complaint in the above entitled cause, and alleges:

Par. 1. That T. Mitchell & Co. were, on the thirty-first day of September, a mining co-partnership, composed of Thomas Mitchell, James J. Fallon and Herman Fawcett, and

were, on the 30th day of September, 1913, by the above entitled court, adjudged to be bankrupts upon petition of creditors of said T. Mitchell and Co., and that the proceedings in bankruptcy were duly referred to W. H. Adams, referee in bankruptcy, residing in Fairbanks, Fourth Judicial Division, Territory of Alaska, and that said bankruptcy proceedings are still pending in the bankruptcy court of said referee (Tr. pp. 4-5).

Par. 2. That thereafter and prior to the commencement of this action, such proceedings were had before said referee, that plaintiff was duly and regularly, by said referee, appointed trustee in bankruptcy in said bankruptcy proceedings, and that the plaintiff is now the duly appointed, qualified and acting trustee in bankruptcy, and as such trustee is entitled to the possession of all of the estate of said T. Mitchell and Co. (Tr. p. 5).

Supplemental Answer:

Denies each and every matter and thing contained in paragraphs one and two of said amended complaint, save and except that defendant admits that T. Mitchell and Company, on the thirty-first day of December, A. D. one thousand nine hundred thirteen, was a mining copartnership composed of Thomas Mitchell, James J. Fallon, and Herman Fawcett (Tr. p. 16).

Amended Complaint:

Par. 3. That the defendant is a corporation duly organized and existing under the laws of the State of Washington; that its principal place of business is at the town of Fairbanks, Fourth Judicial Division, Territory of Alaska (Tr. p. 5).

Par. 4. That within four months prior to the date of said order of adjudication, adjudging said T. Mitchell & Co. bankrupts, to wit, on the *thirty-first* day of *July,* 1913, the said firm of T. Mitchell & Co. *delivered into the possession of the defendant,* at their place of business in said town of Fairbanks, certain *gold dust* belonging to the said firm of T. Mitchell & Co., which said gold dust was then of the *value* of $3,750.27 (Tr. pp. 5 and 6).

Par. 5. That at the *time* of the delivery of said gold dust to said defendant, as aforesaid, the said firm of T. Mitchell & Co. were *indebted to said defendant in a sum greater* than said sum of $3750.27, to wit, in the sum of about $4096.04, which said indebtedness was, at the time of the delivery of said gold dust, *past due* (Tr. p. 6).

Admitted by failure to answer.

Amended Complaint:

Par. 6. That said *defendant* without any authority from said T. Mitchell & Co., or from any member of said firm, *converted* said gold dust and the whole thereof to its own use, and *applied the value* thereof, to wit, the said sum of $3750.27, *toward the payment of said indebtedness* of $4096.04, which was *then past due and owing* from said firm of T. Mitchell & Co. to said defendant (Tr. p. 6).

Answer:

Par. 1. Denies each and every allegation contained in paragraph VI thereof, except that said defendant admits that, on or about August 1, 1913, it *set off the deposit* to the credit of T. Mitchell & Co., named in said amended complaint, which deposit was on the books of said defendant in the amount of $3750.27, *against the past due indebtedness*

then due and owing from said firm of T. Mitchell & Co. to said defendant, in the sum of $4096.04 besides interest thereon (Tr. pp. 11-12).

Amended Complaint:

Par. 7. That *said gold dust was so delivered* into the possession of defendant by said T. Mitchell & Co., as above stated, *with the intention* on the part of said T. Mitchell & Co. *of selling* the same to defendant *and depositing the proceeds* of such sale *to their credit in their general deposit account* in said defendant bank, *and having the same credited to their deposit account*, for the purpose of checking against the same to pay the wages of workmen, then working for said T. Mitchell & Co., as well as to pay the running expenses of the mining operations then conducted by said T. Mitchell & Co., and the said *defendant* unlawfully and without any right or permission, *applied the whole value* of said gold dust, to wit, the said sum of $3750.27 *towards the payment of said indebtedness, then past due and owing,* from said T. Mitchell & Co., to defendant as above stated, and that said *defendant immediately,* after ascertaining the value of said gold dust, *notified* said T. Mitchell & Co. *that it had applied the whole value* of said gold dust, to wit, the said sum of $3750.27 toward the *payment of their past indebtedness,* and then and there notified said T. Mitchell & Co. *that they would not honor any checks against said amount,* and that said T. Mitchell & Co. were not permitted by said defendant, at any time, to check against the same, and that at no time was the value of said gold dust, or any part thereof, placed to the deposit account of said T. Mitchell & Co. in the defendant bank, so as to entitle said T. Mitchell & Co. to check against the same, or any part thereof (Tr. pp. 6-7).

Answer:

Par. 2. Answering paragraph VII thereof, *admits* that the *gold dust* mentioned in said amended complaint was *delivered* to the defendant by said T. Mitchell & Co., *with the intention* on the part of said T. Mitchell & Co. *of selling* same to defendant *and depositing the proceeds* of such sale *to the credit* of said T. Mitchell & Co., *in its general deposit account* at the bank of said defendant, *and having same credited to the deposit account* of said T. Mitchell & Co., and this defendant denies each and every other allegation contained in said paragraph VII (Tr. p. 12).

Amended Complaint:

Par. 8. That at the time of the delivery of said gold dust to said bank, by said bankrupts, as above stated, said bankrupts, to wit: T. Mitchell & Co., composed of the firm of Thomas Mitchell, James J. Fallon and Herman Fawcett, were justly and lawfully indebted to different persons, in an aggregate sum far exceeding the value of the estate of said firm together with that of, and each of, the individual members thereof, and that said firm were, and each of its members was at said time, insolvent, and the said defendant well knew, at said time, that said firm of T. Mitchell & Co. were wholly insolvent, *or* had reasonable cause to believe that they were insolvent, and that defendant well knew at the time of receiving the said gold dust, and at the time of applying the same, or its value, to the payment of the past indebtedness then due, defendant would and did effect a preference whereby defendant would receive a larger percentage of the indebtedness due it from said bankrupts than the other creditors of the bankrupts of the same class, and that said defendant at said time had reasonable cause to believe that the application of said

gold dust, or its value to its past due indebtedness, would effect such preference, and that the same was so applied by said defendant with the purpose of procuring such preference (Tr. p. 8).

Answer:

Par. 3. Answering paragraph VIII thereof, this defendant denies any knowledge or information sufficient to form a belief as to whether or not, at the time of the delivery of said gold dust to said bank by said firm of T. Mitchell & Co., the said firm was justly and lawfully indebted to different persons, in an aggregate sum far exceeding the value of the estate of said firm, together with that of the individual members thereof; and denies any knowledge or information as to whether or not said firm was, and each of its members was, at said time, insolvent; and this defendant further denies each and every other allegation contained in said paragraph (Tr. pp. 12-13).

Amended Complaint:

Par. 9. That the entire value of the estate of said T. Mitchell and Co., bankrupts, is, and ever since, prior to the thirty-first day of July, 1913, was wholly together with the estate of each of the individual members thereof, insufficient to pay the lawful indebtedness of said firm, and that the retention by said defendant of said sum of $3750.27 would pay to defendant a much greater percentage of the indebtedness due to defendant from said T. Mitchell & Co., than would be received by any of the other creditors of the said T. Mitchell & Co. of the same or any class (Tr. pp. 8-9).

Answer:

Par. 4. Denies each and every allegation contained in paragraph IX thereof (Tr. p. 13).

Amended Complaint:

Par. 10. That the plaintiff prior to the commencement of this action, demanded of defendant said gold dust or said sum of $3750.27 the value thereof, but the said defendant refused to deliver said gold dust or to pay any portion of said sum to plaintiff (Tr. p. 9).

Admitted by failure to answer.

Affirmative Answer:

For a further, separate and affirmative defense to the said amended complaint, this defendant alleges:

1. That at the times mentioned in said amended complaint and herein mentioned, the defendant was, and now is, a corporation duly organized and existing under and by virtue of the laws of the State of Washington, and engaged in carrying on a general banking business in the town of Fairbanks, Territory of Alaska.

2. That prior to, and some time subsequent to the first day of August, 1913, the firm of T. Mitchell & Co. was a mining copartnership, composed of Thomas Mitchell, James J. Fallon and Herman Fawcett, engaged in carrying on a general placer mining business in the Fairbanks Mining and Recording Precinct, Fourth Judicial Division, Territory of Alaska.

3. That on the 31st day of July, 1913, the said firm of T. Mitchell & Co. was indebted to this defendant in the sum of $4096.04 on account of overdrafts made by said firm of T. Mitchell & Co. upon its account with the said defendant, and on account of promissory notes theretofore executed by the said firm of T. Mitchell & Co., payable to this defendant, which said amount of $4096.04 is exclusive of any interest due thereon.

4. That on or about July 31, 1913, the *said firm* of T. Mitchell & Co., *sold and delivered* to this defendant *gold dust of the value* of $3,-

750.27 and *directed* that the *said amount be placed to the credit* of said firm upon the deposit books of this defendant, and this *defendant* thereupon on August 1, 1913, caused the said firm of T. Mitchell & Co. to be *credited* with said amount (Tr. pp. 13-14).

Admitted by failure to reply thereto.

Affirmative Answer:

5. That on said August 1, 1913, this *defendant,* with the knowledge and consent of the said firm of T. Mitchell & Co., *set off against the said indebtedness of said firm* of T. Mitchell & Co. to this defendant the said amount of $3750.27, so as aforesaid deposited to the credit of said firm of T. Mitchell & Co. from the proceeds and purchase price of the said gold dust, so as aforesaid purchased from said firm by this defendant (Tr. p. 14).

Reply:

Par. 1. Replying to paragraph V of the further, separate and affirmative defense, *denies* that defendant *set off* against the said indebtedness of said firm of T. Mitchell & Co. to defendant the amount of $3750.27, *with the knowledge or consent of said firm* of T. Mitchell & Co., or with the knowledge or consent of any member of said firm of T. Mitchell & Co., on the 1st day of August, 1913, or at any other time (Tr. pp. 17-18).

Affirmative Answer:

6. That, at the time of the setting off of said deposit to the credit of said firm of T. Mitchell & Co. against the amount of $4096.04, due and owing as aforesaid from said firm to said defendant, neither said defendant nor any of its officers knew, or had any reasonable cause to believe, that said firm of T. Mitchell & Co.,

or any of its members, was insolvent, and that at said time neither this defendant, nor any of its officers, knew, or had any reasonable cause to know or believe, that the setting off of the said amount on deposit as aforesaid, to the credit of T. Mitchell & Co., against the indebtedness of said firm of T. Mitchell & Co. to this defendant would effect a preference, whereby this defendant would receive a larger percentage of the indebtedness due it from the said firm of T. Mitchell & Co. than the other creditors of said firm, of the same class, or any other class, would receive, and the said set-off was made as aforesaid, of said deposit against said indebtedness, without any purpose of securing such preference, or any other preference over and above any other creditor of said firm of T. Mitchell & Co (Tr. pp. 14-15).

Reply:

Par. 2. Denies each and every allegation contained in paragraph VI of said further, separate and affirmative defense, and the whole thereof.

Upon the issues so framed the case went to trial before a jury on the 30th of October, 1915, and over the objection of defendant, plaintiff introduced in evidence all the papers in connection with said bankruptcy matter hereinbefore particularly set forth and described, save and except that defendant made no objection to the introduction in evidence of the petition of the creditors of T. Mitchell & Co. to have said firm adjudged bankrupt.

At the close of plaintiff's case defendant moved for a directed verdict in favor of defendant, or in the event said directed verdict was not given, moved

the court for a nonsuit as against plaintiff (Tr. pp. 106-107), which motions were denied (Tr. p. 107), and exception taken (Exc. 32).

After all the evidence for plaintiff and defendant had been introduced in the case in chief, in defense, and in rebuttal, the defendant renewed its motion for a directed verdict and requested the Court to order the jury to bring in a verdict in favor of the defendant (Tr. pp. 172-173), which said motion was denied (Tr. p. 173), and exception noted by defendant (Exc. 42).

Thereafter the cause was argued by the attorneys for the respective parties, and the jury was instructed by the Court (Tr. pp. 173-183). The defendant presented to the Court certain instructions which it requested the Court to give to the jury, being Proposed Instructions A to I inclusive (found in Transcript on pages 183-188, inclusive), but the Court refused to give said instructions (Tr. p. 188), and to said refusal the defendant excepted (Exc. 43).

Prior to the retirement of the jury, and in the manner prescribed by law, the defendant objected and excepted to certain instructions, numbered 10 to 13, given by the Court (Tr. p. 188), which objections and exceptions were overruled (Tr. p. 189), and an exception duly noted by defendant (Exc. 44). Said defendant likewise, at said time and place, excepted to the Court's eliminating from certain instructions offered by defendant certain parts thereof, as shown by paragraphs C and D

(Tr. p. 189), which exceptions were duly allowed by the Court (Tr. p. 189, Exc. 45).

Before the retirement of the jury to consider its verdict, and within the time prescribed by law, defendant requested the Court to propound five certain special interrogatories to the jury, and the Court, in compliance with said request, submitted said interrogatories to the jury to be by them answered at the same time their verdict was rendered, the Court instructing them that said interrogatories were to be answered either "yes" or "no" (Tr. p. 183). The jury thereupon retired, and after some deliberation returned into Court, stating that they were unable to agree upon answers to all the questions so propounded, and the Court then called the attorneys to the bench and there announced that it was his understanding that the jury might answer such of the questions as they might mutually agree on and leave unanswered such as they could not so agree on (Tr. p. 193). The attorneys for defendant did not waive or relinquish their right to object to the entry of a judgment based upon said imperfect verdict, nor to except and object to a general verdict based upon the inconsistent special findings, nor did they waive any of the rights that might accrue to defendant by reason of the disagreement of the jury in respect to the answer to any question so propounded. The Court thereupon, instructed the jury orally upon the question of their inability mutually to agree upon answers to such special interrogatories and

authorized them to answer any of the interrogatories in other manner than by "yes" or "no", or to leave entirely unanswered such of the questions propounded as they might not mutually agree upon, and to return their general and special verdicts into Court (Tr. pp. 193-194). Thereafter, being interrogated by the foreman of said jury on the specific point as to whether or not the jury might leave unanswered certain of the interrogatories, the Court, to a certain extent, modified the first oral instruction, and informed the jury that, if "yes" or "no" would not form a sufficient answer to any of said interrogatories, they might answer such interrogatory in any manner on which they might mutually agree (Tr. p. 194). The jury again retired and shortly thereafter returned their general verdict against the defendant (Tr. p. 190), and returned their special verdict with three questions answered and two unanswered (Tr. p. 191). The *two* questions so left *unanswered* were the *two* questions which defendant contends were the *most vital* of the five, and without a unanimous verdict thereon there was no basis for a general verdict in favor of the plaintiff, for without answering both questions in the negative there could be no judgment against the defendant.

Thereafter the defendant moved for judgment notwithstanding the verdict (Tr. pp. 195-197), which motion was denied (Tr. p. 197), and an exception noted (Exc. 46).

Defendant filed a motion for a new trial within the time allowed by law (Tr. pp. 197-203), which motion, after argument, was overruled (Tr. p. 203), and exception noted (Exc. 47).

Defendant then filed objections to the entry of any judgment on the general verdict (Tr. pp. 203-204), which objections were overruled (Tr. p. 204), and exception noted (Exc. 48).

Before argument for judgment notwithstanding the verdict, the defendant asked leave of the Court *to amend* paragraph 1 of its answer by changing the words "August 1, 1913," to "July 31, 1913," to conform to the proof offered in said cause, and likewise to amend paragraphs 4 and 5 of its affirmative answer by making similar changes for the same reason, which motion the Court overruled (Tr. pp. 204-205), to which ruling defendant excepted (Exc. 49). The amended complaint states *date* was July 31st and *not* August 1st (Tr. p. 5).

Subsequent to the overruling of the defendant's objection to the entry of any judgment on the alleged general verdict, plaintiff submitted to the Court for signature a form of judgment from which were omitted, in the recitals of the verdict rendered, the two special interrogatories that the jury failed to answer; to the signing of which judgment defendant objected (Tr. p. 211), and the Court overruled said objection, to which ruling defendant excepted (Tr. p. 212, Exc. 50). The Court thereupon signed said judgment as presented,

without causing to be set forth therein the two questions upon which the jury disagreed and which they failed to answer (Tr. pp. 207-211), to which action on the part of the Court defendant excepted (Exc. 51). All of which is shown by the supplemental bill of exceptions (Tr. pp. 211-214).

The case is brought to this Court upon a writ of error.

Argument.

I.

AMENDED COMPLAINT DOES NOT STATE CAUSE OF ACTION.

The amended complaint expressly alleges that within four months prior to the order of adjudication that the copartnership of T. Mitchell & Co. "*delivered into the possession* of the bank gold dust of the value of $3750.27" (Tr. pp. 5, 6, par. IV), "with the *intention* on the part of T. Mitchell & Co. of *selling* the same to the bank *and depositing the proceeds* of such sale *to their credit in* their *general deposit account* in said bank, having the same *credited* to their deposit account *for the purpose of checking* against the same to pay wages of workmen", etc. and "the *Bank applied* the whole value towards the *payment of indebtedness* then past due and owing from T. Mitchell & Co. *to the bank,* and immediately after ascertaining the value of said gold dust *notified* T. Mitchell & Co. that *it had applied* the whole value of said gold dust toward the payment of their past indebtedness and that the

bank would not honor any checks against said amount; and T. Mitchell & Co. were not permitted to check against the same, and that said value was *not placed* to the deposit account in the bank *so as to entitle* T. Mitchell & Co. *to check against the same*" (Tr. pp. 6 and 7, par. VII); "that *at the time* of the delivery of the gold dust to the bank, T. Mitchell & Co. *were indebted to the bank* in a greater sum than $3750.27, to wit: in the sum of $4096.04, which indebtedness was past due" (Tr. p. 6, par. V); that at the time of the delivery of the gold dust, T. Mitchell & Co. were indebted to different persons in an aggregate sum exceeding the value of the estate of said firm and were insolvent, and the bank knew that T. Mitchell & Co. were insolvent OR had reasonable cause to believe they were insolvent, and knew at the time of receiving the gold dust and at the time of applying the value thereof to the payment of the indebtedness then due, the bank would and did effect a preference whereby the bank would receive a larger percentage of the indebtedness due the bank from T. Mitchell & Co. than the other creditors, and the bank had reasonable cause to believe that the application of the value of said gold dust would effect a preference and the same was so applied by the bank with the purpose of procuring such preference" (Tr. pp. 7 and 8, par. VIII).

There is *no* allegation that the gold dust was delivered by Mitchell & Co. *as payment* of their *indebtedness or to be applied on account of their*

indebtedness, *nor* is it alleged that the bank *received* the gold dust *to be* so applied or with any *intention* or for the *purpose* of applying the value thereof to their indebtedness, or to effect or secure to the bank a preference or a greater percentage than any other creditor of the same class; but on the contrary, it *is expressly alleged* that the *intention* of Mitchell & Co. in delivering the gold dust to the bank *was to deposit* its value *to the credit of* Mitchell & Co. *in their generol deposit account* in the bank, to be credited to their deposit account *for the purpose of checking* against the same *"to pay* wages of workmen *then working* as well as *to pay* the *running expenses* of the mining operations *then conducted by Mitchell & Co.* (Tr. pp. 6 and 7, par. VII).

The allegation is then made that the bank *applied* the whole value to the past indebtedness of Mitchell & Co. and *so notified* Mitchell & Co. and that the bank would not honor any checks of Mitchell & Co. against that value; that the bank also notified Mitchell & Co. that they would not be permitted to check against the same, and that it was not *so placed* to the deposit account of Mitchell & Co. *so as to entitle* them *to check* against the same (Tr. pp. 6 and 7, par. VII).

There is in the amended complaint absolutely *no allegation of fraud or collusion* on the part of Mitchell & Co. or on the part of the bank; the value of the gold dust was neither paid by Mitchell & Co.

on account of their indebtedness to the bank nor was it received by the bank as a payment.

Therefore, the legal effect of the allegations of the amended complaint is, that Mitchell & Co. owed the bank $4096.04; that they had a general deposit account in the bank, and that they sold the bank gold dust of the value of $3750.27 to be deposited to their credit in their general deposit account and to have the same credited to their general deposit account so that they could check against such account to pay their mining expenses, etc.

The allegations that the bank then knew they were insolvent and that to offset it against their indebtedness would give the bank a preference and a greater percentage than any other creditor of the same class, do not change or affect the legal result.

Immediately upon such deposit being made by Mitchell & Co. the relation of *debtor and creditor* arose between them and the bank as to the value of this gold dust; the *estate* of Mitchell & Co. *was not thereby diminished* and mutual debts and credits between the bank and Mitchell & Co. existed, and the bank had the legal right at any time thereafter to *offset* this value against the past due indebtedness of Mitchell & Co., and if the bank had not done so *the law would automatically do so* for the bank, and the Court and the Trustee would have done so in the bankruptcy proceeding in ascertaining what the amount of the bank's claim against the bankrupt's estate was, under section 68-a of the Bankruptcy Act.

The defendant asked the Court for a *directed verdict* in favor of defendant (Tr. pp. 172-173), and also moved for judgment notwithstanding the verdict, especially embracing therein that the amended complaint failed to state a cause of action (Tr. pp. 195-196; (3) and (4), p. 196;

U. S. v. Gardener, (9th Circuit), 133 Fed. 285.

The Bankruptcy Act, section 68-a, declares:

> "In all cases of *mutual debts and credits* between the estate of a bankrupt and a creditor the account shall be stated and *one debt shall be set off against the other*, and the *balance only* shall be allowed or paid."
>
> 4 Comp. Stat. 1916, sec. 9652.

In New York County Bank v. Massey, 192 U. S. 138, 24 Sup. Ct. 199, 48 L. Ed. 380, it was held that, even though the bank knew at the time certain deposits were made by its customer that his liabilities greatly exceeded his assets, the bank, under the Federal Bankruptcy Act, was not required to surrender to the trustee in bankruptcy the deposits as a condition precedent to proving the balance of its claim, but it had the right to appropriate the deposit to the payment of the indebtedness of the customer of the bank. It was there said:

> "As we have seen, a deposit of money to one's credit in the bank does not operate to diminish the estate of the depositor, for when he parts with the money he creates at the same time, on the part of the bank, an obligation to pay the

amount of the deposit as soon as the depositor may see fit to draw a check against it. It is not a transfer of property as a payment, pledge, mortgage, gift or security. It is true that it creates a debt, which, if the creditor may set it off under section 68, amounts to permitting a creditor of that class to obtain more from the bankrupt's estate than creditors who are not in the same situation, and do not hold any debts of the bankrupt subject to setoff. But this does not, in our opinion, operate to enlarge the scope of the statute defining preferences so as to prevent setoff in cases coming within the terms of section 68-a. If this argument were to prevail, it would in cases of insolvency defeat the right of setoff recognized and enforced in the law, as every creditor of the bankrupt holding a claim against the estate subject to reduction to the full amount of a debt due the bankrupt receives a preference in the fact that to

Further in the same opinion it is stated:

"It is true, as we have seen, that in a sense the bank is permitted to obtain a greater percentage of its claim against the bankrupt than other creditors of the same class, but this indirect result is not brought about by the transfer of property within the meaning of the law. There is nothing in the findings to show fraud or collusion between the bankrupt and the bank with a view to create a preferential transfer of the bankrupt's property to the bank, and in the absence of such showing we cannot regard the deposit as having other effect than to create a debt to the bankrupt and not a diminution of his estate."

In Studley v. Boylston, 229 U. S. 523, 33 Sup. Ct. 806, 57 L. Ed. 1313, under facts similar to those in the Massey case, and following that case, it was held

that the bank itself had the right to make the appropriation and prove its claim for the balance. It was there stated:

> "If this setoff of mutual debts has been lawfully made by the parties before the petition is filed, there is no necessity of the trustee doing so. If it has not been done by the parties, then, under command of the statute, it must be done by the trustee. But there is nothing in paragraph 68-a which prevents the parties from voluntarily doing, before the petition is filed, what the law itself requires to be done after proceedings in bankruptcy are instituted."

In Germania Savings Bank & Trust Co. v. Loeb, 188 Fed. 285-288, 110 C. C. A. 263, 266, the Circuit Court of Appeals for the Sixth Circuit stated the doctrine of the Massey case as follows:

> "It has been authoritatively decided by the Supreme Court, in considering these two sections, that the balance of a regular bank account at the time of filing the petition is a debt due to the bankrupt from the bank, and in the absence of fraud or collusion between the bank and the bankrupt, with the view of creating a preferential transfer, the bank need not surrender such balance, but may set it off against notes of the bankrupt held by it, and may prove its claim for the amount remaining due on the notes."

Where the account between the bankrupt's estate and the person or corporation charged with having received a preference is an account current, the balance of the account, when the transactions cease, is to be taken in determining whether there has been an advancement by the bankrupt's estate which

would constitute a voidable preference. If the bankrupt's estate has not been diminished by reason of the transactions, there is no voidable preference.

C. S. Morey Mercantile Co. v. Schiffer, 114 Fed. 447, 52 C. C. A. 249;

Dickson v. Wyman, 111 Fed. 726, 49 C. C. A. 574, 55 L. R. A. 349;

Jaquith v. Alden, 189 U. S. 78, 23 Sup. Ct. 649, 47 L. Ed. 717.

In the last case cited, speaking upon this question, it was said:

> "The account was a running account, and the effect of the payments was to keep it alive by the extension of new credits, with the net result of a gain to the estate of $546.89, and a loss to the seller of that amount less such dividends as the estate might pay."

To constitute a preferential transfer within the meaning of the Bankruptcy Act there must be: First, a parting with the bankrupt's property for the benefit of the creditor; and, second, diminution of the bankrupt's estate. In Continental Trust Co. v. Chicago Title Co., 229 U. S. 435, 33 Sup. Ct. 829, 57 L. Ed. 1268, it was said:

> "This case must be dealt with in the light of certain principles established by decisions of this court in determining the applicable provisions of the Bankruptcy Act. To constitute a preferential transfer within the meaning of the Bankruptcy Act there must be a parting with the bankrupt's property for the benefit of the creditor and a consequent *diminution* of the bankrupt's estate."

It is well settled as a general proposition that a bank has the right to set off any indebtedness it may hold against the bankrupt against a general deposit standing to the credit of such bankrupt. This is expressly allowed by section 68 of the Bankruptcy Act. See Collier on Bankruptcy (10th Ed.) p. 976 et seq. Whether the bank charges off the deposit of its customer and applies it on the indebtedness which it holds against the customer, or whether it draws a check in the name of the customer covering his deposit and applies it as a credit on the indebtedness, or whether it does neither of these things, but appeals to the law to do the same thing in effect, makes no difference as a legal proposition. Toof v. City National Bank (C. C. A. 6th Circuit), 30 Am. Bankr. Rep. 79, 206 Fed. 250, 124 C. C. A. 118; Studley v. Boylston National Bank (U. S. Sup. Ct.) 30 Am. Bankr. Rep. 161, 229 U. S. 523, 33 Sup. Ct. 806, 57 L. Ed. 1313; Continental etc. Savings Bank v. Chicago Title & Trust Co., 30 Am. Bankr. Rep. 624, 229 U. S. 435, 33 Sup. Ct. 829, 57 L. Ed. 1268; Chisholm v. First National Bank (Ill. Sup. Ct.) 35 Am. Bankr. Rep. 598, 269 Ill. 110, 109 N. E. 657; New York County National Bank v. Massey, 192 U. S. 138, 24 Sup. Ct. 199, 48 L. Ed. 380; Lowell v. International Trust Co. (C. C. A. 1st Circuit) 158 Fed. 781, 86 C. C. A. 137, 19 Am. Bankr. Rep. 853; In re Radley Steel Construction Co. (D. C.) 212 Fed. 462, 32 Am. Bankr. Rep. 514.

Considering the question relative to the subsequent advancements, the rule of the federal courts

is that a security transferred for future advances, in the absence of fraud or collusion, does not constitute a voidable preference.

> Tomlinson v. Bank of Lexington, 145 Fed. 824; 76 C. C. A. 400;
>
> Van Iderstine v. National Discount Co., 227 U. S. 575; 33 Sup. Ct. 343; 57 L. Ed. 652.

The doctrine in these two cases may be stated by quoting a paragraph from the syllabus of the Tomlinson case, as follows:

> "Where a bank allowed a customer to overdraw on the express agreement that the customer should assign good accounts for collection to pay the overdraft, the subsequent assignment of the accounts, although the customer was insolvent, did not constitute the giving of a preference."

In Putnam v. U. S. Trust Co. (Sup. Ct. Mass. March, 1916), 36 Am. Bankr. Rep. 658, 664, the Court, where a *payment* was made, and referring to section 68-b, Bankruptcy Act, said:

> "This section requires as a condition for recovery by the trustee in bankruptcy against the creditor, *three* distinct facts: The bankruptcy, that the transaction then effected a preference, and that the creditor had reasonable cause to *believe* that a preference was being effected. The only serious contention which can be made in this connection is respecting the last factor, whether the defendant at the time of receiving these three payments of $500 each, had 'reasonable cause to *believe*' that these payments would effect a preference.

"The governing principles of law upon this point are in substance that reasonable cause to *believe* is *not* the equivalent of reasonable cause to *suspect*. The two 'phrases are distinct in meaning and effect'. It is not enough that a creditor has some cause *to suspect* the insolvency of his debtor, but he must have such a *knowledge of facts* as to induce a reasonable belief of his debtor's *insolvency,* in order *to invalidate* a security taken for his debt. To make mere *suspicion* a ground of nullity in such a case would render the business transactions of the community altogether too insecure. It was never the intention of the framers of the act to establish any such rule. A man may have *many grounds of suspicion* that his debtor is in *failing* circumstances, and yet have *no cause* for a well grounded *belief* of the fact. He may be *unwilling to trust* him further; he may *feel anxious* about his claim, and have a strong desire to secure it—and yet *such belief* as the act requires may be *wanting.* Obtaining additional security, or receiving *payment* of a debt *under such* circumstances is *not prohibited by law.* Grant v. Nat. Bk., 97 U. S. 80, 81; Stucky v. Masonic Sav. Bk., 108 U. S. 74; In re Chicago Car Co., 211 Fed. 628; Rosenman v. Coppard, 228 Fed. 114."

In Am. Bk. & T. Co. v. Coppard, 227 Fed. 597, 35 Am. Bankr. Rep. 742, the Circuit Court of Appeals, Fifth Circuit, said:

"The question presented is of great importance to the business of banking, upon which the prosperity of the country so largely depends. It is true, that if an insolvent, within four months antecedent to bankruptcy, should make deposits or give checks to a bank to enable it to secure a preference, the transaction would be inimical to the bankruptcy law, and would be held void as a preference.

"But, when an insolvent customer makes a deposit with his bank, in good faith, and in the usual course of business, at any time within four months before the petition in bankruptcy is filed against him, the bank is allowed to credit the amount on notes of the bankrupt held by it. New York County N. Bk. v. Massey, 192 U. S. 138, 48 L. Ed. 380, 11 Am. Bankr. Rep. 42.

"A case more nearly in point, however, is that of Studley v. Boylston Nat. Bk., 229 U. S. 527, 57 L. Ed. 1313, 30 Am. Bankr. Rep. 161. There the Court restricted its attention to the bank's right of *setoff, under* section 68-a and 68-b of the Bankruptcy Act, * * *. This controlling precedent is additionally important because there the setoff was made by checks drawn by the bankrupt against his account in the bank, and credited on past due indebtedness, as in the case at bar * * *.

"We deem this conclusion of the Supreme Court, salutary and sound. An honest man of business, though embarrassed and possibly insolvent, may not be deprived of the great aid of legitimate banking. Though in deep water, one is not forbidden to swim to safety if he can. Since there is nothing in the record betraying any evidence of fraud, or evasion of the bankruptcy law, on the part of the bankrupt or the bank, we must hold that the latter was entitled to the instruction it sought."

The allegations of the complaint that the partnership *sold and delivered* the gold dust to the bank, the *value* thereof to be credited to the partnership in their account with the bank, *resulted* immediately in the creation of *mutual debts and credits* between the partnership and the bank, and these mutual debts and credits, even if not *offset* by the

bank, must be offset by authority of the law, section 68-a of the Bankruptcy Act, and the *balance* only, that act says, shall be allowed or paid.

So that, however these allegations are viewed, they show conclusively, that *without fraud or collusion* on the part of the partnership or the bank, the partnership owed and was indebted to the bank, in the sum of $4,096.04, and on the sale and delivery of this gold dust to the bank, the bank became indebted to the partnership for its value; there therefore existed mutual debts and credits, which section 68-a of the Bankruptcy Act says must be *offset* against each other, *either* by the bank, or by the law automatically, or by the Court whenever and wherever called upon to declare what is the amount of *the debt* between the partnership and the bank.

II.

PLAINTIFF IN THE CASE AT BAR HAD NO AUTHORITY TO INSTITUTE THIS ACTION TO RECOVER PROPERTY OF THE FIRM OF "T. MITCHELL & CO." AS HE HAD NEVER FILED ANY BOND OR UNDERTAKING, AS PRESCRIBED BY THE BANKRUPTCY ACT, AS TRUSTEE FOR THE ESTATE OF THE COPARTNERSHIP OF T. MITCHELL & CO., AND NO APPLICATION WAS MADE EITHER BEFORE OR DURING SAID TRIAL OR SUBSEQUENT THERETO, ASKING PERMISSION TO FILE SUCH AN UNDERTAKING. THE ONLY BOND GIVEN WAS AS TRUSTEE OF THOMAS MITCHELL, JAMES J. FALLON AND HERMAN FAWCETT (Tr. p. 47).

One of the essential prerequisites to the right of a trustee to administer the estate of a bankrupt

is the execution of a bond to the United States in such sum as may be fixed by the creditors. Subdivision B of section 50 of the Bankruptcy Act provides as follows:

> "*Trustees, before entering on the performance* of their official duties, and within ten days after their appointment, or within such further time, not exceeding five days, as the Court may direct, *shall* respectively *qualify by* entering into a *bond to* the United States, with such sureties as shall be approved by the Courts, conditioned for the faithful performance of their official duties."

Subdivision C of section 50 of said act provides for the creditors fixing the amount of the bond, or in the event of their failure so to do, that said amount shall be fixed by the Court. The Court will observe, by an examination of plaintiff's exhibit G-1 (Tr. pp. 47-48), that no attempt was made by the plaintiff in the case at bar to qualify as prescribed by law. The instrument is headed "In the matter of T. Mitchell & Co., bankrupt". G. F. Johnson and two sureties then bind themselves unto the United States in the sum of one thousand dollars. The condition recited in the bond is in part as follows:

> "The condition of this obligation is such that, Whereas the above named G. F. Johnson was, on the 16th day of October, A. D. 1913, appointed trustee in the case pending in bankruptcy in said Court *wherein Thomas Mitchell, James J. Fallon, and Herman Fawcett are the bankrupts,* and he, the said G. F. Johnson, has accepted said trust and all the duties and obligations pertaining thereto,

> Now, therefore, if the said G. F. Johnson, *trustee as aforesaid,* shall obey such orders as said Court may make, *in relation to said trust,* and shall faithfully and truly account for all the moneys, assets and effects of the estate *of said bankrupts* which shall come into his hands and possession, and shall in all respects faithfully perform all his official duties as such trustee, then this obligation to be void; otherwise to remain in full force and virtue."

No mention is made in said purported bond, elsewhere than in the caption thereof, which is not referred to in the body of the instrument, of the firm of T. Mitchell & Co., and the only reference to any obligation on the part of said trustee under said bond is to administer the estate of the three individuals named therein, to wit, Fallon, Mitchell, and Fawcett. The question naturally presents itself as to what would be the liability of the bondsmen under said bond should property of T. Mitchell & Co., a copartnership, come into the possession of the trustee and be by him converted to his own use. The firm of T. Mitchell & Co. has never been adjudicated bankrupt. The trustee, plaintiff in this action, the principal obligor under said bond, was never appointed as trustee of the estate of T. Mitchell & Co., and the said bond does not purport to be anything other than a bond guaranteeing his faithful administration of the assets of Fallon, Mitchell, and Fawcett. By what theory could the sureties under said bond be held liable for any default on the part of said Johnson in the administration of any of the property

belonging to the firm of T. Mitchell & Co., a copartnership? As the giving of a bond is an absolute prerequisite to the right of a trustee to administer an estate, and as no such bond was given in the estate of T. Mitchell & Co., the plaintiff in the case at bar has never qualified as administrator of the estate of T. Mitchell & Co. and consequently has no authority to institute an action to recover property claimed to be the property of said copartnership. The above bond was the bond *approved* by the referee in bankruptcy; that bond is a bond as trustee of the *individual* partners' estates and *not* of the *partnership* of "T. Mitchell & Co." Under the Bankruptcy Act, section 21d, a certified copy of the *order approving* the bond vests title in the trustee; and therefore, title to the *partnership* property of "T. Mitchell & Co." *never vested in* this trustee, and the trustee cannot maintain this suit to recover *partnership* property.

We are aware that there are some decisions that hold that where the question of a trustee's failure to give a bond is raised in a State Court the presumption is that the trustee duly qualified by complying with the provisions of the statute relating to the bond, but that rule is not applicable in the case at bar, for that is one of the issues presented in the case, and plaintiff attempted to prove the fact and introduced in evidence the only bond given by the said trustee, which shows on its face that it is *not* a bond in the case of *T. Mitchell & Co.*

Section 50 of the Bankruptcy Act provides:

> "If any referee or *trustee shall fail to give a bond as herein provided* and within the time limited, he shall be deemed to have declined his appointment, and such failure shall create a vacancy in his office."

Counsel respectfully submit that no bond was ever given, or attempted to be given, in the partnership estate, and that, even if the partnership had been adjudged bankrupt, which it was not, plaintiff in the case at bar would have no authority to institute or prosecute said action.

Exception 5, Tr. pp. 43-44.

Failure to give a bond creates a vacancy.

Bankruptcy Act, Sec. 60-b.

III.

THE COPARTNERSHIP OF T. MITCHELL & CO. WAS NEVER ADJUDGED BANKRUPT BY THE COURT AND THE COURT ERRED IN ADMITTING IN EVIDENCE THE ALLEGED ADJUDICATION IN BANKRUPTCY, PLAINTIFF'S EXHIBIT D (Tr. pp. 39-40, Exc. 4).

The Court will observe, from the reading of said alleged adjudication, that the adjudication is confined to "Thomas Mitchell, James J. Fallon, and Herman Fawcett, copartners under the firm name of T. Mitchell & Co.", and the actual words of adjudication are as follows:

> "The said Thomas Mitchell, James J. Fallon, and Herman Fawcett, copartners doing business under the firm name and style of T.

> Mitchell & Co., are hereby declared and adjudged bankrupt accordingly;"

that is, the *individuals* composing the firm. There is no adjudication of the copartnership of "T. Mitchell & Co." as a bankrupt. The order of reference, plaintiff's exhibit F (Tr. pp. 41-42) recites:

> "Whereas Thomas Mitchell, James J. Fallon, and Herman Fawcett, copartners under the firm name and style of T. Mitchell & Co., of the Fairbanks Precinct, Fourth Division, Territory of Alaska, on the 30th day of September, 1913, were duly adjudged bankrupt," etc.,

and the order further recites:

> "Ordered that said matter be referred to W. H. Adams, referee in bankruptcy of this Court, to take such further proceedings therein as are required by said acts, and that said Thomas Mitchell, James J. Fallon, and Herman Fawcett shall attend before said referee on the 16th day of October, 1913," etc.

The bond given by the trustee (Tr. pp. 47-48) recites as follows:

> "Whereas the above named G. F. Johnson was, on the 16th day of October, A. D. 1913, appointed trustee in the case pending in bankruptcy in said Court, wherein Thomas Mitchell, James J. Fallon, and Herman Fawcett are the bankrupts."

At no place is there an adjudication that the firm of T. Mitchell & Co. was bankrupt, and without such adjudication the trustee in bankruptcy

would have no jurisdiction to administer the estate of T. Mitchell & Co. or any portion thereof.

Volume 3 Ruling Case Law, sec. 48, p. 213, holds:

> "The uniform current of authority is that the adjudication of a partnership a bankrupt, apart from, or in addition to, the adjudication of its partners bankrupt, is indispensable to the jurisdiction of a court of bankruptcy to adminster the partnership property;" citing In re Berthenshaw, 157 Fed. 363, 85 C. C. A. 61, 13 Ann. Cases 986, 17 L. R. A. (N. S.) 886.

In treating of this subject, Collier on Bankruptcy, 9th Ed., pp. 146-47, says:

> "But a partnership now is something other than that under the law of 1867. There the words were, 'two or more persons who are partners in trade.' Now it is 'a partnership' that 'may be adjudged a bankrupt.' This phrasing, coupled with other clauses, has led to the doctrine that a partnership is in bankruptcy a legal entity—a joint relation where the identity of the members has been lost—and that, therefore, the individuals and the partnership are entities separate and distinct from each other. A partnership being a distinct entity, it owns its property and owes its debts apart from the individual property of its members which it does not own, and apart from the individual debts of its members which it does not owe. It may be adjudged bankrupt, although the partners who compose it are not so adjudicated. In other words, the firm must petition or be petitioned against; if the latter, the firm, or a member of it acting within the scope of the partnership, must have committed the act of bankruptcy; and, if adjudication follows, *the firm, or nomine, must be adjudicated.* Under this principle a partner-

ship as an entity may be adjudged to be a bankrupt, irrespective of any adjudication against the individual members."

In Loveland on Bankruptcy, vol. 1, p. 549, the learned author says:

"Where a partnership is not adjudged a bankrupt, the partnership property is not drawn into bankruptcy for administration, but only the individual assets of the partners adjudicated bankrupt. Where the Court obtains jurisdiction of one of the partners, it has power to adjudicate the firm and all of the partners bankrupt and to administer the partnership and individual property. *If, however, the Court does not adjudicate the firm bankrupt, the firm property is not drawn into bankruptcy.*"

This question has been passed upon a number of times by the various Circuit Courts, and the case of In re Mercur in the Third Circuit, 122 Federal 384, is directly in point. In that case the Court holds as follows:

"Where all the members of a firm are adjudicated bankrupts, but there has been no adjudication against the firm, the trustee appointed in the individual cases has no authority to interfere with firm assets, though all the cases were instituted simultaneously by the same creditor and the same trustee appointed for all the partners. In the contemplation of the bankruptcy act of 1908 the partnership is a distinct entity, which requires a petition specifically directed against it, alleging an act of bankruptcy in which it is expressly involved, and resulting in an adjudication against the partnership itself, irrespective of and in addition to any that may be made against the indi-

> vidual members; and simultaneous proceedings against the individual members of a partnership do not necessarily bring the partnership into Court so as to authorize an amendment calling for an adjudication against it."

In that case the contention was that, as the individual partners had been adjudged bankrupts, and amendment should be allowed to bring the partnership property into Court, but the Court ruled as above set forth and cited a great number of authorities as found in 122 Fed. 389.

In the case of Mills v. J. H. Fisher & Co., from the Sixth Circuit, decided in 1908, 159 Fed. 898, the Court says:

> "So distinct are the assets of the members of the firm from that of the firm that when all the members of the firm are adjudged bankrupt individually and the firm is not so adjudged, the trustee of the individual members was adjudged not to be entitled to administer firm assets which were in the hands of a trustee under an assignment made by the firm. Amsinck v. Bean, 22 Wall. 395, 22 L. Ed. 801; In re Mercur, 122 Fed. 384."

The Circuit Court for the Eighth Circuit, in In re Berthenshaw, 157 Fed. 363, on page 371, says:

> "The uniform current of authority is that under this act (act of 1898) a partnership is a distinct entity separate from the individuals who compose it, that it owns its property and owes its debts, which are respectively separate and distinct from the individual property and the individual debts of its partners, and that an adjudication of the partnership a bankrupt apart from, or in addition to, the adjudication

> of its partner's bankrupts, *is indispensable to the jurisdiction of a court of bankruptcy to administer the partnership property.* In re Mercur, 122 Fed. 384, 388, 58 C. C. A. 472, 476; In re Stein & Co., 11 Am. Bankr. Rep. 536, 538, 127 Fed. 547, 62 C. C. A. 272; In re Corcoran, 12 Am. Bankr. Rep. 283, 287; In re Sanderlin (D. C.) 109 Fed. 857-859; In re Meyers, 98 Fed. 976, 979, 39 C. C. A. 368, 371; Strause v. Hooper (D. C.) 105 Fed. 590; In re Farley (D. C.) 115 Fed. 359, 361; In re Meyers (D. C.) 96 Fed. 408, Id., 97 Fed. 757; In re Russell (D. C.) 97 Fed. 32; Green River Deposit Bank v. Craig (D. C.) 110 Fed. 137; In re McFaun (D. C.) 96 Fed. 592; In re Barden (D. C.) 101 Fed. 553; In re Hale (D. C.) 107 Fed. 432."

So far as counsel's investigations disclose, the doctrine enunciated in the cases cited above has never been overruled or modified. We are aware that the United States Supreme Court, in the case of Francis v. McNeil, 228 U. S. 695; 57 L. Ed. 1029, in discussing the Berthenshaw case, on the question of whether or not the property of the individual members of the copartnership is brought into Court to be administered when the copartnership itself is adjudged bankrupt, does not follow the rule on that subject laid down in the Berthenshaw case, but approves the ruling made in the case of Boccaro v. Security Bank, 43 C. C. A. 279; 103 Fed. 436-442. But the point there involved was entirely separate and distinct from the point involved in the case at bar, and they were considering a separate subdivision of section 5 of the Bankruptcy Act. The Supreme Court there held

that the entity theory did not extend to the proposition that there could be any insolvency of the copartnership without an insolvency of the individual members composing it, but did not criticize any of the Circuit Courts of Appeal holding that it was absolutely necessary to have adjudication of the copartnership itself before the property of the copartnership could be adminstered by the trustee appointed for the individual members of the partnership.

As the copartnership of Mitchell & Co. was not adjudged bankrupt, a trustee appointed as trustee of the assets of the individual members of said copartnership would have no jurisdiction over the property of the firm of Mitchell & Co., and in the case at bar would have no authority to institute this action based upon the adjudication in bankruptcy of the individual members only, and the Court erred in admitting in evidence the alleged order of adjudication.

The foregoing argument is applicable to the exceptions taken by the defendant to the admission in evidence of plaintiff's exhibit F, being the alleged order of reference (Tr. pp. 41-42, Exc. 5), as said order is entirely in reference to the individual assets of the three members of the copartnership; also to the admission of plaintiff's exhibit G (Tr. pp. 45-46), which was the appointment of the trustee by the referee, wherein the referee attempts to appoint a trustee in the estate of T. Mitchell & Co., bankrupts, when they had not been adjudged

bankrupts; to the acceptance by the trustee of said alleged appointment (Tr. p. 45), which is also entitled "In the matter of T. Mitchell & Co., bankrupts"; to plaintiff's exhibit G-1 (Tr. pp. 47-49), which is a bond given by said trustee; and to the order approving said bond (Tr. p. 46); all of which is covered by defendant's exceptions Nos. 5, 6, and 7 (Tr. pp. 43-44).

No evidence having been introduced by the plaintiff showing that the *copartnership* of T. Mitchell & Co. had ever been adjudged bankrupt, nor that the trustee had given bond as trustee *of the partnership,* and the plaintiff in the action at bar had no right to prosecute said action and defendant's motion for nonsuit at the close of plaintiff's case should have been granted (Tr. pp. 106-107, Exc. 32).

As heretofore shown, an attempt was made to appoint the plaintiff in the case at bar trustee of the estate of T. Mitchell & Co. and of the individual members composing said firm, but as the copartnership had never been adjudged bankrupt said trustee would have no authority or jurisdiction to administer said estate, and plaintiff utterly failed to prove the essential allegations of his amended complaint, as found in paragraphs 1 and 2 thereof (Tr. pp. 4 and 5).

IV.

THE CASE ON THE MERITS.

On the *merits* of the case at bar the position of the plaintiff in error is briefly as follows:

(I) That when T. Mitchell & Co., in the afternoon of the 31st of July, 1913, sold and delivered to the American Bank of Alaska gold dust of the value of $3750.27,

(a) That said delivery was made in the due course of business;

(b) That said gold dust was sold to said bank;

(c) That the value thereof was immediately ascertained and credited to the general account of T. Mitchell & Co. on the records and books of the bank, and in their pass book, and offset against their indebtedness to the bank;

(d) That the title to said gold dust became vested in said bank as soon as it was delivered to the bank;

(e) That when the value thereof was credited to T. Mitchell & Co. on the records and books of the bank, and in their pass book, it became an ordinary commercial deposit;

(f) That such deposit when so credited automatically extinguished the overdraft; though in fact it was credited and offset against their indebtedness;

(g) That the bank had the absolute right then and at any time thereafter to charge against said

account the overdue notes of T. Mitchell & Co. then in the possession of said bank;

(h) That had the bank not made this charge of that overdue paper against said account, the trustee would have been compelled to make it under section 68-a of the Bankruptcy Act had said T. Mitchell & Co. afterwards become bankrupt;

(i) That no preference was created, as said term is used in the National Bankruptcy Act.

(II) That the bank had no knowledge at the time of the receipt of said gold dust and the crediting of said account on the books of the bank and on the pass book of T. Mitchell & Co., that said firm was insolvent.

(III) That the bank did not then have reasonable cause to believe that, by receiving said deposit, and crediting it to their general account, it would work a preference in favor of said bank, as said term is used in Bankruptcy Act.

(IV) That the occurrences that precipitated the bankruptcy of T. Mitchell & Co. happened subsequent to the time of the receipt of said deposit by the bank.

(V) That the levying of a garnishment on the bank subsequent to the time of the making of said deposit and the charging of the notes and overdraft against said deposit account, in an action instituted by Rutherford and Widman without the knowledge or connivance of the bank, was only a contributory factor in precipitating the bankruptcy.

(VI) That the extinguishment of the overdraft and the charging of the overdue notes against said deposit did not, in itself, contribute even remotely to the failure of said T. Mitchell & Co.

We respectfully submit to the Court that, of all the propositions above set forth, the only ones essential to support the position of plaintiff in error were the establishment of the fact that the gold dust was received in the due course of business, the value thereof credited to the deposit account of T. Mitchell & Co., and the immediate charging against said account of the overdue paper of T. Mitchell & Co., then held by the bank; and if these facts were established, plaintiff in this action could not prevail.

We desire to call the Court's attention to the unique theory upon which the case of the defendant in error was predicated in the lower Court and the theory upon which the jury apparently based its verdict, to wit, that a "deposit" is not a deposit unless the depositor is permitted to check out the entire sum deposited; that an overdraft can not be extinguished until the depositor draws a check against his deposit, payable to the bank, and delivers said check to the bank to be credited against the overdraft; that an entry to the depositor's account on the credit side of the ledger does not in itself offset a debit entry in an equal, greater, or less amount, but that the bank is presumed to perform some other affirmative act,—the nature thereof being somewhat indefinite,—before such

setoff can occur. Applying this theory to the case at bar when the bank credited the proceeds of the sale of the gold dust to the account of T. Mitchell & Co., that it was not a "deposit", for the depositor was not permitted to check out the whole sum so credited; that as it was not a deposit it could not be set off against the indebtedness of T. Mitchell & Co.; that the bank did no other affirmative act and made no entry of a solemn declaration in its books that any setoff had taken place as against the overdraft, and that therefore the fund still remained intact and the indebtedness of T. Mitchell & Co. was not diminished in any amount; etc., *ad infinitum ad absurdum.* In the case at bar, the money was advanced by the bank and was used to pay the bankrupt's creditors part of their wages, to purchase the groceries consumed by them, and that they had already once received the value of the gold dust that they now claim the bank wrongfully converted. Fallon testified the bank paid $3071 *labor checks* between July 16th and 31st (Tr. p. 67). Through the bank's allowing overdrafts and advancing money on notes and paying their checks therewith, they had already received in benefits the value of the gold dust extracted by them, long before it was actually taken from the ground. The bank furnished the means that enabled their employers to conduct mining operations, to give them employment at five dollars a day and board, and to purchase the necessary supplies to enable them to continue work.

They were on the ground and knew infinitely better than the bank whether or not the mining operations could be successful. The bank had no representative on the ground, nor was it supposed to have one. The bank received no benefits,—not even interest on such moneys as were loaned to the operators. It handled the third cleanup in no different manner from either of the other cleanups theretofore had. It had a promse of the operators to deliver the gold dust to the bank after each cleanup, and from the assurances given to the bank by the operators and their past experience as respects the first two cleanups, the bank felt safe in advancing more funds than the operators had on deposit. They trusted the operators in order to help them to get started at a time when they had no funds of their own, and would probably have continued to permit overdrafts had no suit been commenced against the operators, but when suits were instituted by other creditors good business methods forbade further advancements.

Wherein was the bank at fault? Was it in advancing money to pay the money and buy provisions for them before they had taken out the gold dust necessary to pay for them? If so, who but the laborers and merchants and other creditors now clamoring for this money received the benefit? Had the bank not permitted an overdraft, had it advanced no money on notes, and had the operators become bankrupt after the third cleanup, what would have been the tangible assets of the bank-

rupt firm? Obviously the value of the gold dust, and the bank had already advanced and the creditors had received the benefit of $345.87 in excess of the value of the gold dust so extracted, and the crediting by the bank of the value of the gold dust on the overdraft and overdue notes did not diminish the estate of said bankrupts.

The *net result* of the bank deposits and credits allowed was *gain* to the bankrupts' estate, and *not* voidable preferences. This is the *"net result rule"*, applied in bankruptcy matters, and sustained by the following cases:

Jaquith v. Alden, 189 U. S. 78;
Yaple v. Dahl-Millikan G. Co., 193 U. S. 526;
Wilde & Co. v. Provident L. & T. Co., 214 U. S. 292.

There can be *no* preference where the bankrupts' estate is *not diminished.*

As shown below and from their own evidence and the admitted facts, they opened their account with a credit which the bank gave them on their note for $200, were always overdrawn and closed owing the bank an overdraft of $345.90; and if the credit and offset of the *third* cleanup, constituted a voidable preference, so also did the credit and offset of the *first and second* cleanups, because there was no difference in what was done each time and the course of dealing was always the same from first to last.

The deposit of the value of said gold dust, sold to the bank on the 31st of July, 1913, to the credit of T. Mitchell & Co. was not a transfer constituting a preference and did not diminish the estate.

> "A deposit of money in a bank upon an open account subject to check is not a transfer constituting a preference, although the bank as a creditor has the right to set off its claim against the deposit."
>
> Collier on Bankruptcy, 9th Ed., p. 807, citing
>
> In re Hill Co., 130 Fed. 315, 16 Am. Bankr. Rep. 733.

> "A deposit of money to one's credit in a bank does not operate to diminish the estate of the depositor, for when he parts with the money he creates at the same time on the part of the bank an obligation to pay the amount of the deposit as soon as the depositor may see fit to draw check against it. It is not a transfer of property as a payment, pledge, mortgage, gift, or security."
>
> New York County Natl. Bank v. Massey, 192 U. S. 138.

When the bank purchased from T. Mitchell & Co. the gold dust in controversy the relation of debtor and creditor arose, and the bank had an absolute right to set off, as against the claim of T. Mitchell & Co., any indebtedness due from T. Mitchell & Co. to the bank.

In the case at bar T. Mitchell & Co. was, on the afternoon of the 31st of July, 1913, indebted to the bank for overdrafts in the sum of $2246.14 (Tr. p. 166-b), and also owed to it one $850 note,

another $500 note, and another note the amount of which does not appear but which was in excess of $150, making a total indebtedness to the American Bank of Alaska of a sum greater than the amount of the bank's indebtedness to T. Mitchell & Co., and thus, immediately on the consummation of the sale of said gold dust mutual debits and credits existed between the bank and the firm of T. Mitchell & Co., thus bringing the case squarely within the provisions of section 68-a of the National Bankruptcy Act, which is as follows:

> "In all cases of *mutual debts or mutual credits* between the estate of a bankrupt and a creditor, the account shall be stated, and *one debt shall be set off against the other* and the *balance only* shall be allowed or paid."

> "A bank is entitled to set off certain demand notes of a bankrupt when an action is brought by the trustee to recover moneys on deposit."
>
> Collier on Bankruptcy, 9th Ed., p. 977, citing Steinhardt v. Natl. Park Bank, 19 Am. Bankr. Rep. 72, 120 N. Y. App. Div. 255; Irish v. Citizens' Trust Co., 21 Am. Bankr. Rep. 39, 163 Fed. 880.

The Court will notice a distinction that plaintiff in error has attempted to avoid in connection with the time of the setoff of the notes, that no adjudication of bankruptcy had been made of T. Mitchell & Co., or of any of the members of said firm, at the time of said setoff, and no petition was filed to have them adjudicated bankrupts until some weeks later. Over ten thousand dollars had been

spent by T. Mitchell & Co. in opening up the mining ground and the ground was looking better and they expected to continue work. Plaintiff in said action endeavored to secure some testimony from Mr. Fallon that he notified Mr. Bruning that he would have to shut down if he was not permitted to draw any more checks against the account (Tr. p. 171):

> "Q. State when it was that you notified Mr. Bruning that if the checks of that firm would not be honored that you would have to shut down?
>
> A. Well, Judge Pratt, *those words never came out of my mouth* in my testimony, *about me shutting down.*
>
> Q. Some different words then?
>
> A. *No sir.*"

It appears from the evidence that there was no thought in the minds of the members of the copartnership that they would have to shut down, and that they were merely chagrined that they could not continue to overdraw from the bank, and it was only later, when they found they could not obtain funds to carry on their work, that they acknowledged themselves bankrupt.

The deposit of the value of the gold dust delivered by T. Mitchell & Co. to the American Bank of Alaska was a "general deposit" in the due course of business.

The gold dust in controversy, the proceeds of the third cleanup, was delivered to the bank in the same manner as the first and second cleanups; was in a similar manner sold to the bank, and as

soon as the gold dust was thoroughly cleaned and weighed and computation made to ascertain the value thereof, based upon the market value of that particular gold dust, to wit, $16.47 an ounce, the amount so ascertained, $3750.41, was, before 6 p. m. on the 31st of July, 1913, credited in the pass book of T. Mitchell & Co.

A "general deposit" is defined in 3 Ruling Case Law 517 as follows:

> "A general deposit is a deposit generally to the credit of the depositors, to be drawn upon by him in the usual course of the banking business. A special deposit is a deposit for safe keeping, to be returned intact on demand or for some specific purpose not contemplating a credit on general account,"

citing a number of authorities. No contention was made that this account was a special deposit and all the evidence shows that it was not treated, or expected to be treated, any differently than any other cleanup had been. The same authority, page 513, says:

> "A deposit in a bank is presumed to be general in the absence of an agreement to the contrary. This is placed on the ground that such a deposit is esteemed the most advantageous to the depositor and most consistent with the general objects, uses, and course of business of banks."

A large number of illustrations in a great variety of cases on what constitutes a general deposit is set forth at 3 Ruling Case Law 518.

In the case of a general deposit of money in bank, the moment the money is deposited it becomes the

property of the bank and the bank assumes the legal relation of debtor and creditor.

This statement is taken from the text in section 149 on page 519 of 3 Ruling Case Law and is supported by a hundred or more ruling cases. The legal relation of debtor and creditor as regards the value of the gold dust in controversy, as between the bank and T. Mitchell & Co. was created upon the entry by the bank of the credit of $3750.43 in the bank's records, before 6 p. m. on the 31st of July, 1913. All the evidence in the case at bar shows that the credit was entered in the bank records before 6 p. m. on the 31st day of July, 1913, and the proper credit slips for the attention of the bookkeeper were prepared at said time and placed in the bookkeeper's file for attention on the next banking day, although the credit was not made by the bookkeeper in the individual ledger until the 1st of August, 1913. Counsel respectfully submit that the time when T. Mitchell & Co. was credited with said deposit was governed by the time the credit was entered in the bank records, and not by the time when it was entered in the individual ledger.

> "The time when a deposit is made is fixed by the time the fund is delivered to the bank and credit therefor given in the depositor's pass book, although the credit to the depositor on the books of the bank is not made until some time afterwards."
>
> 3 R. C. L. 531;
>
> Wasson v. Lamb, 120 Ind. 514, 22 N. E. 729, 16 A. S. R. 342, 6 L. R. A. 191.

Mr. Bruning, the cashier of the bank, when interrogated about the time the garnishment was served on the bank in the case of Rutherford and Widman v. T. Mitchell & Co., testified as follows (Tr. p. 120):

"Q. When was the garnishment in the case of Rutherford and Widman against Mitchell & Co. served upon the bank, Mr. Bruning?

A. My recollection is that it was in the evening of the 31st, at 8 or 9 o'clock in the evening.

Q. Where were you when the papers were served on you?

A. I think I was sitting in the front of the bank there. That was when the bank was over here (indicating).

Q. When the bank was in this store in this building right across the street from the courthouse?

A. Yes, that is my recollection.

Q. Was your day's work completed at the time you were sitting there?

A. Yes.

Q. Had these entries that you speak of having been made in the books here, crediting him up, and the charges against the account,—had they been completed at the time this garnishment was served upon you?

A. The books were all locked up.

Q. Had the deposit slip for their account been made out at that time?

A. All finished for the day.

Q. Had the notes been charged against the account and set off against the account before the attachment was levied?

A. The notes and the debits had been made against the account.

Q. Was the account closed, so far as the bank was concerned, at that time?

A. It was.

Q. All that remained to be done was the physical entries in the individual ledger by the bookkeepers?

A. On the following day; yes."

There was introduced in evidence the general deposit slip made out on the 31st day of July, 1913, by Mr. Bruning, the cashier (Tr. p. 111), which was as follows:

"Deposited in American Bank of Alaska, Fairbanks, Alaska, July 31, 1914, under the head of 'checks,'—85 per cent. 267.87 oz. Advanced 16.40, $3734.12."

An explanation of the method of handling the deposits is made by Mr. Bruning on pages 109-111 of the Transcript. After the gold dust was cleaned by Mr. Hopkins, the gold dust teller, and weighed, he made out a slip, which was introduced in evidence (Tr. p. 112), and is as follows:

"Gold dust purchased. No. 4309. American Bank of Alaska, 7-31-1913. Adv. 267.87. M. & Co. 227.69 3734.12. Hoffman 40.18 659 at 16.40 per oz. Pay to the order of Mitchell & Co. 4393.12. Hop."

Mr. Pratt, testifying for plaintiff, corroborates the time garnishment was served as between 8 and 9 o'clock (Tr. pp. 103-104).

That was on the 31st of July, 1913. The amount of the deposit slip was then credited to T. Mitchell & Co. and the record thereof for the bookkeeper was made by Mr. Bruning, as shown by defendant's exhibit 2, heretofore referred to. The bank book introduced in evidence (Tr.

p. 77) shows a credit of $3750.27 to T. Mitchell & Co., which was the true value of the gold dust entered in said pass book on August 2, 1913, after said gold dust had been thoroughly cleaned and weighed, the amount shown by Mr. Hopkins' slip being the amount advanced on the gold dust as soon as it was received.

On cross-examination Mr. Bruning testified in regard to the time when the various acts hereinbefore referred to were performed (Tr. p. 146), as follows:

> "Q. Give your best estimate of how long it was before that gold dust was cleaned up so that you would know exactly what its value was.
>
> A. I might bring Hopkins up here and he might remember. Hopkins handled the gold dust. All the transaction took place before six o'clock that night. If he got there at four it might have been an hour and a half.
>
> Q. You are sure the whole thing happened, and it was all cleaned up and the amount ascertained before six o'clock?
>
> A. Yes sir.
>
> Q. And just as soon as you got it ascertained, you set it off against the notes and overdraft.
>
> A. As soon as I made out the deposit slip, so that I knew how much the cleanup amounted to, I charged up the notes, as that slip shows.
>
> Q. You made the setoff right then and there?
>
> A. Certainly I did.
>
> Q. Before six o'clock?
>
> A. As soon as—— (interrupted)
>
> Q. (continuing). ——on the evening of July 31st, 1913?

Mr. CLARK. Let him finish his answer.
A. Yes sir."

Further, on cross-examination, Mr. Bruning testified (Tr. p. 148) as follows:

"A. I state that the evening or the afternoon that the gold dust was delivered at the bank and the boys were cleaning the dust, that I told Mr. Fallon that their overdraft amounted to so much on the ledger; that I would place the cleanup to their credit as soon as I ascertained what the amount was, and that I would charge the demand notes in the bank against the account."

The evidence shows that Mr. Bruning did not make up his mind not to advance any further moneys until after the garnishment was served, and on cross-examination (Tr. p. 150) the following testimony was given:

"Q. Didn't you make up your mind that you would not cash any more over-checks when you saw that cleanup of $3734.00?
A. No, I made up my mind when I was served with the garnishment; then I made up my mind that I wouldn't——(interrupted).
Q. Wait. You told this jury that you did all this before six o'clock——(interrupted).
Mr. CLARK. Let him finish his answer.
The COURT. Finish your answer.
Mr. PRATT. Didn't you tell this jury a while ago that that was all finished before six o'clock?
The COURT. You may finish your answer, if you have not finished it.
(Question and answer read as follows: Q. Didn't you make up your mind that you wouldn't cash any more over-checks when you saw that cleanup of $3734.00? A. No, I made up my mind when I was served with the gar-

nishment; then I made up my mind that I wouldn't——)

A. (continuing). ——that I would not cash any more checks or allow any more overdrafts."

Again (Tr. p. 152), Mr. Bruning testified:

"A. I have told you and will tell it again; that we made the credit as soon as the dust was weighed, and right after that I charged up the notes.

Q. That was before six o'clock?

A. That was before six o'clock."

In explanation of his reason for refusing to allow any further overdrafts we find (Tr. p. 152) the following:

"Q. I tried to get you to tell when it was that you made up your mind that you wouldn't cash any more checks of T. Mitchell & Co.—overchecks. That was six o'clock, was it?

A. No.

Q. When was it?

A. I told you after the garnishment. The testimony will show that I was garnisheed about 8 or 9 o'clock.

Q. Then you made up your mind for a certainty that you would not cash any more checks if they were overchecks?

A. Certainly.

Q. You knew then that Mitchell & Co. didn't have anything on file?

A. I knew they had nothing to their credit.

Q. That meant that you were not going to cash checks at all?

A. As long as I wasn't allowing any overdraft.

Q. Why wouldn't you cash any more checks for them?

A. Because when a house is on fire I am not going to place insurance.

Q. You knew the house was on fire at that time?

A. Certainly. When a man jumps another with an attachment, it is about time to keep hands off.

Q. You knew at six o'clock that your house was on fire, didn't you?

A. I did not.

Q. You didn't think so?

A. No sir."

As an example of the unique theory on which counsel for defendant in error was trying the case, we find in the testimony (Tr. p. 156) the following:

"MR. PRATT: I want to know if that money was deposited in your bank subject to the check of T. Mitchell & Co. at any time; was it deposited there, I mean subject to check at any time after 6 or 8 o'clock in the evening of July 31st, 1913?

(Defendant objects and the Court rules that the witness need not answer until Mr. Pratt explains what he means by 'deposited subject to check').

Q. I mean a fund in your bank that if the depositor should issue a check and somebody should go there with it, that you would pay it?

A. If there is a balance to their credit we will pay it.

MR. PRATT: Ain't that a fair question and a fair understanding?

MR. CLARK: That is a fair understanding.

MR. PRATT: Now, was that sum of money subject to check, in the ordinary way of business now of banking, by T. Mitchell & Co. at any time after 6 or 8 o'clock in the evening of July 21 (evidently means 31), 1913? That is a fair question. Now, answer that, whether it was or not.

A. It was a checking account like all other accounts, and checks will be honored against an account, where there is a balance, or if there is an arrangement for an overdraft.

Q. You call that an answer, do you?

A. Yes.

Q. It just don't answer anything. Would your bank have cashed a check of T. Mitchell & Co. at any time after the hour that I have named?

A. Not after nine o'clock at night; no.

Q. Would you the next day?

A. No.

Q. Therefore, Mitchell & Co. didn't have any deposit subject to check after 6 or 8 o'clock in the evening of July 31, 1913, did they?"

This line of questioning speaks for itself and requires no comment.

At page 159 of the Transcript, Mr. Bruning gives further explanation of the transaction as follows:

"Q. How much was that firm in the red on the evening of the 31st?

A. On the afternoon of July 30th, as well as upon the 31st, at 3 o'clock, when the bank closed, they were overdrawn $2246.14. Between 3 and 6 o'clock they made a deposit of this amount of gold dust, which was put to their credit, and that wiped out the overdraft and left a balance which was charged up to the notes of $850.00, $500.00, and what that other item is.

Q. When did you put those notes on that running account, just as though it was a checking account?

A. As soon as the credit had been placed, that is, when the gold dust slip had been given to me, I made out the deposit slip. I ascertained how much the deposit amounted to above

> the overdraft, and I went to work and applied the surplus on those notes; that is, I charged the notes, treated them the same as a check; charged the notes against the account."

From the foregoing it will be seen that all credits were given and offsets made against the value of the gold dust before the close of the bank on the 31st day of July, 1913, and all that remained thereafter to be done was the physical act of entering said credits in the individual ledger by the bookkeeper.

The account of the *partnership* was opened with the bank about June 9, 1913 (in fact, June 11, 1913, Tr. p. 77); the *first cleanup* was July 3, 1913, of $1904, which was turned into the bank, credited to their account and they checked against it (Tr. p. 55); the *second cleanup* was July 16, 1913, of $2280, which was put in the bank to their credit just the same as the first and checked against (Tr. p. 56); the *third cleanup* was July 31, 1913, of $3750.14, which was brought to the bank (Tr. p. 59) and "left it there to be blown and credited the same as before" (Tr. p. 63); and "from the 16th to the 31st of July, 1913, we owed the bank a balance of $4096.04 on notes and overdrafts. That was the total indebtedness of the firm to the American Bank on the 31st of July, 1913" (Tr. p. 60).

This is the evidence of Fallon, the partner having full charge of the matters, and shows that the *same* usual course of dealing with the bank existed and was followed with this *third* cleanup of $3750.14

that was followed with the first and second cleanups, viz: *credited* to firm account, and notes due and overdraft charged and *set off* against the cleanup, *still leaving an overdraft* due the bank of $345.90 (Tr. p. 30).

The fact is, that Mitchell & Co. were overdrawn and in debt to the bank for checks drawn, constituting overdrafts from the time they opened their account until the bankruptcy proceeding, and still owe the bank an overdraft of $345.90.

THE EVIDENCE FOR PLAINTIFF SUMMARIZED.

Fallon, one of the partners, the one who had the full charge of the matters involved here, as a witness for the plaintiff testified:

> "The copartnership had an 85 per cent lease on the Hoffman bench or ground. I kept the books. I was looking after the clerical end of it and the commissary end, and I had all dealings with the merchants (Tr. p. 50). The copartnership owned the lease on the Hoffman bench (Tr. p. 51). Prior to June 9, 1913, the debts that we incurred were $1500; the partnership owed me for the money I had advanced them, and we owed the American Bank of Alaska about $400 (Tr. p. 53).
>
> The *first* cleanup was on July 3, 1913, and amounted to $1904, which was turned into the American Bank of Alaska. We had an account there; it was credited to us and I drew checks for everybody, and they were honored—in fact, further than the money that was there to cover it, which made an *overdraft* (Tr. p. 54). We owed the bank $1400 when the first cleanup was brought in. The checks for *wages* and for merchandise, too, were *all honored* (Tr. p. 55).

The *second* cleanup was July 16, 1913; it was $2280. We brought it in and put it in the bank. The bank put the gold or its proceeds to our credit just the same, carried along. We checked against it and all checks were honored (Tr. p. 56).

The *third* cleanup was supposed to be in on the 26th, but the water was low and very muddy and it was a very dry season and everyone was up against it, and Mitchell said we better wait until we get a bigger cleanup. We ought to have cleaned up every ten days, but it was postponed until the 30th of July. Mr. Bruning of the bank telephoned me once and wanted to know when the cleanups were coming in. I told him it was postponed until the 28th, and that Mitchell expected a pretty good cleanup; that it would be eight thousand and would cover everything (Tr. p. 57). He said, 'You have no money, and these notes and overdraft here, and he had deposited his note for $500 to meet the checks to reduce the overdraft. He said, 'I hope you do have a good cleanup.' He made no inquiries after that (Tr. p. 58).

The *third* cleanup was July 30, 1913. It was $3750.14. I brought it in to the bank on the night of the 31st, between 5 and 6 o'clock. We then owed the bank $1504, represented by notes of $850, overdraft of $133 and $500 on deposit to reduce the overdraft, making it $1504 (Tr. p. 59).

Our indebtedness to the bank on July 31, 1913, was $4096.14 on notes and overdraft. For *labor* the bank *paid* $3071.50 *in labor checks,* and for bills, merchandise and one thing and another (Tr. p. 60), $1804, from the 16th to the 31st of July, 1913. The indebtedness for labor on that date was $6773 (Tr. p. 60). As shown by our schedules we owed for other accounts $7532.75. We had, as shown by our schedules, $1786 in mining machinery and out-

fit, and assets and liabilities, as shown by our schedules on July 31, 1913 (Tr. p. 61). We still had the lease of the mining property on July 31, 1913 (Tr. p. 62).

The gold dust of our *third* cleanup, *I took it into the bank* (Tr. p. 62). Mr. Hopkins was tending me. I waited to see it weighed up, and it corresponded with our weight out there, and *I left it to be* blown and *credited the same as before.* I went in between 7 and 8 o'clock to see if it was cleaned up yet, and it was not, and I said: *'I will call in the morning'* (Tr. p. 63). I went in about 9:20 o'clock *in the morning* and I asked for my book. Mr. Bruning said, 'Jim, I am sorry to tell you that it has been my instructions to get all overdrafts in, and I have applied it and disbursed it.' He gave me my book and vouchers, and he said he couldn't carry me any longer (Tr. p. 63). I left my book when I left the gold dust. He did not return it *that* morning, but did the *next* morning, the morning of August 2nd. After he told me that I said, 'Mr. Bruning, good gracious, I have made out the checks for the men. Are you not going to carry us a little while longer?' He said, 'I have got to get all the overdrafts in. It is my instructions. I have got to carry them out.' And I said, 'Well, we are up against it then; we can't check against that dust' (Tr. p. 64).

There were $3071 *labor* checks and $1800 paid by the bank between the 16th and the 31st. The amount of our indebtedness up to July 31, 1913, *for labor* would be, deducting $3071 from the total, would leave $3000 (Tr. p. 69).

Mr. Bruning and I did *not* discuss the affairs of the partnership and venture, any more than to say, 'Well, how is she going?' Of course, the *second* cleanup I brought in, the mine was beginning to show up a little better, and we had bright hopes for the next cleanup, that it

would be considerably better and that we would be able to wipe out all our obligations (Tr. p. 71). When the cleanup came in *I didn't talk* with Mr. Bruning that night. I just handed the dust to Mr. Hopkins, who said he would attend to it immediately. And when I went back there Mr. Bruning was there, and he said, 'We are not quite ready yet, Jim.' I said, 'Let her go until the morning.' So I went home (Tr. p. 71). I had the gross amount of the gold dust, on the night of the 31st, the same as it tallied when Paul Rettig weighed it up.

Mr. Marquam: On the 31st of July, 1913, or at any other time, did Mr. Bruning or any other member of the bank make inquiry of you in regard to your financial standing or the financial standing of the firm or its individual members, that you did not answer?

A. No, sir, they never inquired of me (Tr. p. 72).

Our bank book shows that on July 31, 1913, there was *placed to our credit* $3750.27. That is the gold dust, the money derived from the sale of the gold dust. They paid us $16.47 per ounce.

And all the other money that we deposited in the bank in connection with our mining was deposited with the bank and entered up in this book with the vouchers (Tr. p. 73).

The first and second cleanups were also entered in our bank book, as well as the third cleanup.

August 2, 1913, they balanced up my book and returned our vouchers, showing they had paid out and cashed $6329.70 since it was balanced before. They *credited* our account with this *last cleanup* and charged against our account the notes that we have there, and that still left us an overdraft of $133.70. They did *not* treat this *third* cleanup any different from

what they treated any other deposit in the way it was entered up. They put it in just the same as the others, but instead of acknowledging that they could check against it—to be checked against. I couldn't issue any checks against it, because it was all taken up on the overdrafts and the checks that had been issued during the cleanup, between the time of the cleanup (Tr. p. 74).

Mr. Bruning had deposited $500 to our credit to carry us along. He put in his own note to the bank to cover that overdraft'' (Tr. pp. 75-76).

The bank book of Mitchell & Co. was in evidence, as follows:

DEFENDANT'S EXHIBIT "1."
(Tr. p. 77)

Dr. American Bank of Alaska in acc't with Mitchell & Co. Dr.

1913						
June	11	Deposit	400.	July 16 1913 Checks as per List 51 Vouchers Ret'd		3353.65
	19	"	100.			
July	3	135.81 at 16.50	1904.75			
	7	Deposit	165.19			
	8	"	850.			
		Overdraft	133.71			
			3353.65			3353.65
July	18	85 per cent of 16.50 158.70 oz.	2213.14	Jul 16 1913 Overdraft		133.71
				Aug 2 67 Cks per list		6329.70
July	19	Dep. by A. Bruning to reduce overdraft	500.			
July	31	85 per cent 267.87 at 16.47	3750.27			
			6463.41			6463.41

"Work was going on while I was in here on the 31st of July. They were continuing work. The ground looked fairly good at that time. The ground was looking better. It was getting better as we went along (Tr. p. 78).

During that period I called up Mr. Bruning and asked him if he would not honor the checks until the cleanup got in. He said that was all right. I told Mr. Bruning on the morning of August 1st that the ground was looking very good and we were going ahead (Tr. p. 80).

I never told Mr. Bruning at any time that things were not looking well out there (Tr. p. 80). I recognized that Mr. Bruning had done the best he could (Tr. p. 81).

I never told Mr. Bruning or gave him any intimation as to the amount of checks that were outstanding, only a simple statement that the checks for the full amount of these wages were outstanding (Tr. pp. 83, 84).

Harry E. Pratt, attorney for the creditor who garnisheed the bank, testified *for plaintiff* that the garnishment was served about 8:30 or 9 o'clock in the evening of July 31, 1913. Mr. Pratt said he asked what he caught with his garnishment, and they replied that he didn't catch anything. Mr. Pratt asked how about that cleanup that came in this afternoon? They said in reply, 'They were away in the red to us, and we just *credited* that cleanup and they are still away in the red' " (Tr. pp. 103-104).

Judge Pratt, for plaintiff, asked Fallon:

"Q. State *when* it was that *you notified* Mr. Bruning that *if the checks* of that firm would *not be honored* that you would *have to shut down?*

A. Well, Judge Pratt, those words never came out of my mouth in my testimony, about me *shutting down.*

Q. Some *different* words?
A. No, sir" (Tr. p. 171).

We ask the Court to bear in mind, first, that the bankruptcy petition was *filed August* 23, 1913 (Tr. p. 25); second, that it was an *involuntary petition;* third, that these partners *confessed* that they were *then* unable to pay their debts and *consented* that they be adjudged bankrupt (Tr. p. 25); fourth, that their schedules show they owned property valued at $3286 (Tr. p. 38); that there is nothing stated as to their *lease or its value,* either in the schedules or in the evidence on the trial, although it was growing *richer* with each cleanup, the *first* $1904 (Tr. p. 54), the *second* $2280 (Tr. p. 56), and the *third* 3750.27 (Tr. p. 74); fifth, that the *bank paid* out for *labor checks* $3071 between July 16th and July 31st, 1913 (Tr. p. 60); sixth, that they asked the bank to honor the checks *until the cleanup got in* (Tr. p. 79); seventh, that the *period* of time involved in all of the business relations between the bank and Mitchell & Co. was from June 11, 1913, when they commenced with their first bank transaction and July 31, 1913, one month and twenty-one days, when the gold dust was sold to the bank, credited to Mitchell & Co. and *offset* against their indebtedness (Tr. p. 77, Tr. p. 53); eighth, that the bank honored their checks and paid out for them during that period $9683.35 (Tr. p. 77), and received and bought and credited gold dust from their three cleanups, $7934; ninth, that from July 16th to July 31st, fifteen days, the bank *paid* out for *labor checks*

on plaintiff's own evidence $3071 (Tr. p. 60) and while the evidence does not clearly show the *labor checks* paid by the bank from June 11 to July 16, 1913, thirty-five days, it may fairly be assumed that the bank paid for their *labor checks* during that period at least one and one-half times as much, viz: $4606, making a total of $7677 paid by the bank *for labor;* and as to those *labor checks paid* by the bank, the bank is entitled *to be subrogated,* and be reimbursed as being in the *same class* as the unpaid *labor* which is of the same class; so that, under no possible view or circumstances could the $3750.27 of the third cleanup be considered a preference to the bank or be held to give the bank a greater percentage of its claim than the other *labor* claims of the *same class.*

Herman Fawcett, another of the partners, testified for plaintiff:

> "*I heard* there was to be an attachment served against the gold dust, and I went in to find out whether anything could be done. I understood the man who was levying was Jack Nelson. I asked Mr. Bruning and he said 'No, that it could not; *it had been applied* to overdrafts and *checks* that had been left there for collection' " (Tr. pp. 100-101).

Mr. Bruning's evidence will be found at pages 107 to 169 of the *Transcript,* and is full, clear and given after a most *searching* cross-examination, showing absolutely no facts or knowledge or grounds of belief, *either* that the partnership was insolvent *or* what their total or any indebtedness was, *or* that

he was effecting or intending to *or* did effect a preference or obtain a greater percentage over others of the same class or of a different class, when he credited the value of the third cleanup and offset it against their indebtedness to the bank.

Not only that, but that he had not refused and had not intended to refuse to allow them to check or to honor their checks, *until* after and between 8 or 9 o'clock of July 31, 1913, when the *garnishment* was served upon the bank (Tr. p. 153), which was between 8 and 9 o'clock of July 31, 1913 (Tr. p. 103); and then, for the *first* time, he knew someone was suing them and that they were in some trouble.

There is not a syllable of evidence in the record showing that the bank or anyone connected with the bank knew or had heard or had any grounds or reason to believe or even suspected they were insolvent or in financial difficulties, or what they owed, until the petition in involuntary bankruptcy and their schedules were filed *after* August 22, 1913 (Tr. p. 25).

Certainly, the bank would *not have paid* $3071 *labor checks* (Tr. p. 60), between July 16th and July 31st, 1913, had the bank either known, or believed, or suspected, that Mitchell & Co. were insolvent or in financial difficulties, when they paid these $3071 of *labor checks,* and Mitchell & Co. *already* owing them *then* a large sum for notes and overdrafts.

In Foster v. McAlester, 114 Fed. 145, 52 C. C. A. 107, the Circuit Court for the Eighth Circuit said:

> "Fraud cannot be inferred either by the Court or jury from acts legal in themselves, and consistent with an honest purpose. The settled rule on this subject is that slight circumstances, or circumstances of an equivocal tendency, or circumstances of mere suspicion, leading to no certain results, are not sufficient to establish fraud. They must not be, when taken together and aggregated, when interlinked and put in proper relation to each other, consistent with an honest intent. If they are, the proof of fraud is wanting."

In Nichols v. Elken, 225 Fed. 689, 140 C. C. A. 563, the Circuit Court of Appeals for the Eighth Circuit used this language:

> "Mere suspicion, of course, is not sufficient to charge the defendants with knowledge of, or reasonable cause to believe, Tilden's insolvency at the time of these payments; but there must be evidence of facts sufficient to put a reasonably prudent person upon inquiry, which, if pursued, would show that Tilden was insolvent and that a preference would be the result of making these payments."

The remarks of the Federal Supreme Court in Grant v. National Bank, 97 U. S. 80, 24 L. Ed. 971, are pertinent here. It was said:

> "It is not enough that a creditor has some cause to suspect the insolvency of his debtor; but he must have such a knowledge of facts as to induce a reasonable belief of his debtor's insolvency, in order to invalidate a security taken for his debt. To make mere suspicion a ground of nullity in such a case would render the busi-

ness transactions of the community altogether too insecure. It was never the intention of the framers of the act to establish any such rule. A man may have many grounds of suspicion that his debtor is in failing circumstances, and yet have no cause for a well-grounded belief of the fact. He may be unwilling to trust him further, he may feel anxious about his claim, and have a strong desire to secure it, and yet such belief as the act requires may be wanting. Obtaining additional security, or receiving payment of a debt, under such circumstances, is not prohibited by the law. Receiving payment is put in the same category, in the section referred to, as receiving security. Hundreds of men constantly continue to make payments up to the very eve of their failure, which it would be very unjust and disastrous to set aside. And yet this could be done in a large proportion of cases if mere grounds of suspicion of their solvency were sufficient for the purpose.

The debtor is often buoyed up by the hope of being able to get through with his difficulties long after his case is in fact desperate; and his creditors, if they know anything of his embarrassments, either participate in the same feeling, or at least are willing to think that there is a possibility of his succeeding. To overhaul and set aside all his transactions with his creditors, made under such circumstances, because there may exist some grounds of suspicion of his inability to carry himself through, would make the bankrupt law an engine of oppression and injustice. It would, in fact, have the effect of producing bankruptcy in many cases where it might otherwise be avoided.

Hence the act, very wisely, as we think, instead of making a payment or a security void for a mere suspicion of the debtor's insolvency, requires for that purpose that his creditor should have some reasonable cause to believe

him insolvent. He must have a knowledge of some fact or facts calculated to produce such a belief in the mind of an ordinarily intelligent man.

It is on this distinction that the present case turns. It cannot be denied that the officers of the bank had become distrustful of Miller's ability to bring his affairs to a successful termination; and yet it is equally apparent, independent of their sworn statements on the subject, that they supposed there was a possibility of his doing so. After obtaining the security in question, they still allowed him to check upon them for considerable amounts in advance of his deposits. They were alarmed; but they were not without hope. They felt it necessary to exact security for what he owed them; but they still granted him temporary accommodations. Had they actually supposed him to be insolvent, would they have done this?"

In In re Wright-Dana Hardware Co., 212 Fed. 397, 400 et seq., the Circuit Court of Appeals for the Second Circuit said:

"The right of a bank to a set-off as against a bankrupt depositor was passed upon by the Supreme Court of the United States in New York County National Bank v. Massey, 192 U. S. 138, 24 Sup. Ct. 199, 48 L. Ed. 380, a case which went up from this circuit, and which was decided in 1903. The bank in that case, as in this, had exercised a right of set-off, and it was claimed that the transaction amounted to giving a preference to the bank by enabling it to receive a greater percentage of its debts than other creditors of the same class. But the Supreme Court upheld the bank's right to the set-off. The Court in reaching its conclusion said that a deposit of money to one's credit in a bank did not operate to diminish the

depositor's estate, for when he parted with the money he created at the same time, on the part of the bank, an obligation to pay the amount of the deposit as soon as the depositor might see fit to draw a check against it. It did not amount to a transfer of property as a payment, pledge, mortgage, gift, or security. It continued:

'It is true that it creates a debt, which, if the creditor may set it off under section 68, amounts to permitting a creditor of that class to obtain more from the bankrupt's estate than creditors who are not in the same situation, and do not hold any debts of the bankrupt subject to set-off. But this does not, in our opinion, operate to enlarge the scope of the statute defining preferences so as to prevent set-off in cases coming within the terms of section 68-a. If this argument were to prevail, it would, in cases of insolvency, defeat the right of set-off recognized and enforced in the law, as every creditor of the bankrupt holding a claim against the estate subject to reduction to the full amount of the debt due the bankrupt receives a preference in the fact that to the extent of the set-off he is paid in full.'

The question came before the Supreme Court again in Studley v. Boylston National Bank, 229 U. S. 523, 33 Sup. Ct. 806, 57 L. Ed. 1313, decided in 1913, where it was held that nothing in the bankruptcy act deprives a bank with which the insolvent is doing business of the rights of any other creditor taking money without reasonable cause to believe that a preference will result; and, it being found that the deposits and payments of notes were not made to enable the bank to secure a preference by the right of set-off, the bank had a right to set off the deposits against the notes within four months of the bankruptcy.

But conceding the law to be as above stated, it is insisted that the facts of the case at bar are such as to deprive the Utica City National Bank of the right of set-off which, under other circumstances, it might exercise. Our attention is called to the fact that the referee found that the Wright-Dana Company was insolvent on September 15, 1911 (four months before bankruptcy), and continued to be insolvent to the date of its adjudication in bankruptcy on February 5, 1912, and that during the whole of that time the fact of its insolvency was known to the bank. All this may be true and yet not deprive the bank of its right of set-off. A bank may do business in the usual manner with one it knows to be insolvent. The mere fact of insolvency, or mere knowledge of the insolvency of the depositor, is not alone sufficient to take away the bank's right of set-off. As said in Studley v. Boylston National Bank, supra:

'There is nothing in the statute which deprives a bank, with whom an insolvent is doing business, of the rights of any other creditor taking money without reasonable cause to believe that a preference will result from the payment. The Bankruptcy Act contemplates that, by remaining in business and at work an insolvent may become able to pay off his debts. It does not prevent him from continuing to trade, depositing money in bank, drawing checks, and paying debts as they mature, either to his own bank or any other creditor. It does provide, however, that if bankruptcy ensues, all payments thus made within the four months' period may be recovered by the trustee, if the creditor had reasonable cause to believe that a preference would be thereby effected.' "

V.

BURDEN OF PROOF IS ON TRUSTEE TO PROVE BANK HAD REASONABLE GROUNDS TO BELIEVE THAT MITCHELL & CO. WERE INSOLVENT ON JULY 31, THAT RECEIVING AND CREDITING GOLD DUST TO THEIR ACCOUNT WOULD GIVE BANK GREATER PERCENTAGE THAN OTHER CREDITORS OF SAME CLASS, AND THAT OFFSETTING AGAINST INDEBTEDNESS WOULD EFFECT AN UNLAWFUL PREFERENCE.

Clifford v. Morrill, 230 Fed. 190, decided in January, 1916, very clearly shows what this *burden* is and how it must be met by the trustee, and had many circumstances showing embarrassment, attachment, etc., of the *debtors,* but none of which were sufficient to meet the requirements of the *present* Bankruptcy Act, as sufficient to justify holding a *payment preference* there to be voidable.

That Court said:

> "Morton, District Judge. That Morrill had reasonable cause to believe that the Somerset Woolen Company was insolvent, *in the common-law meaning* of the term, *is clear.* The *change in the definition* of "insolvency" made by the *present* Bankruptcy Act (Act July 1, 1898, c. 541, 30 Stat. 544) *greatly increases the burden on the trustee* in cases of this character. It *now* devolves upon him *to show* that the defendant *had reasonable cause to believe that the bankrupt's property, at a fair valuation, was less than its indebtedness at the time when* the payments in question *were made.* This seems to require either *actual knowledge* of the property and debts *on the part of the person receiving* the alleged *preference,* or *knowledge* by him of circumstances warranting the inference that the debts probably exceeded the prop-

erty. No knowledge of the first sort is brought home to Morrill. He did not know of the Feiner mortgage; but *he does not seem to have been intentionally shutting his eyes to the facts or evading knowledge* of them.

'It is clear that the creditor cannot be said to have had reasonable cause to believe such a preference was intended, unless the evidence shows that it knew, or ought to have known, the substantial truth as to the bankrupt's financial condition.' Dodge, J., In re Houghton Web Co. (D. C.), 185 Fed. 213, 214, 26 Am. Bankr. Rep. 202, 204.

Such inferences of insolvency, if any, as might be drawn by Morrill or his attorney from the mortgages, the slowness in paying him, and the failure promptly to get rid of his attachment—and there is little else on which to find 'reasonable cause to believe'—are to be considered in connection with Morrill's ignorance of the total indebtedness of the Somerset Woolen Company, the hopeful assertions of its managers, the misleading statements of condition made by them, the appraisal which had been exhibited to him, the facts that the company was running its plant as usual and did not appear to be in difficulties with any other creditors, and various other circumstances tending to repel such inference. On all the evidence it is not shown that Morrill, at the time when he received any of the payments in question, had reasonable cause to believe that the Somerset Woolen Company was insolvent, or that the effect of the payments would be a preference to him over other creditors."

See, also, cases hereinbefore quoted to the same effect.

VI.

LABOR CLAIMS HAVE A CLASS PRIORITY UNDER THE BANKRUPTCY ACT, SECTION 64-b, AND THE PLAINTIFF'S EVIDENCE SHOWS THAT DURING THIS SAME PERIOD OF THE THIRD CLEANUP, JULY 16TH TO JULY 31, 1913, FIFTEEN DAYS, THE BANK PAID $3701 LABOR CHECKS, AND PRESUMABLY THE SAME AMOUNT BEFORE DURING THIRTY-FIVE DAYS, AND THE BANK WAS SUBROGATED TO THE LABOR CLASS FOR THOSE PAID LABOR CLAIMS, EXCEEDING THE $3750.27 DEPOSIT.

The bank paid $3071 for *labor checks* (Tr. p. 67) from July 16 to July 31, 1913, fifteen days, and presumably double the same amount from the time it commenced paying on June 11, 1913, thirty-five days more, or $6142 a total of $9213. The *total labor* claims were $6773 (Tr. p. 60). The balance of *labor* claims, after deducting the $3071 so paid by the bank was $3702.

Claims for labor have *priority* by section 64-b of the Bankruptcy Act, and as the bank is entitled to be *subrogated* to the claims of the *class* it paid the $3071 for, viz.: *labor checks,* it received out of the $3750.27 of gold dust on July 31, $679 greater than the bank's percentage of that class, *labor,* whose claims to the amount of $3071 it had so paid (Tr. p. 67), and taking the total assumed of *labor* claims paid by the bank during the previous *thirty-five days* as double or even as only *half* that sum, would make the bank's percentage $4606 or $856 *less* than it received, as the schedules show $3286

of assets (Tr. p. 38) applicable to the payment of *labor* claims, having *priority.*

How then, is it possible to say the bank received a *larger percentage* than any other *labor* creditor of the same (labor) class? That is the *test* in section 60-b, of the Bankruptcy Act of a *voidable* preference.

In Lowell v. International Trust Co., 158 Fed. 781, 783, 784, the Circuit Court of Appeals for the First Circuit, where a voidable preference, *by payment,* was asserted, the Court held:

> "The plaintiff also urges on us that in New York Bank v. Massey, the bank took no action formally or otherwise, but merely left it to the law to offset the deposit made by the bankrupt against his indebtedness, while in the case at bar we must accept the statement that the defendant charged up its demand loans against the deposit, or, in other words, went through the formalities of certain alleged journal entries. This, however, was ineffectual either way, whether to benefit or prejudice the International Trust Company. It only gave expression to what the law itself would accomplish, that is, it cleaned up the set-off and left it where the law itself would have left it. At law, it takes two parties to accomplish an effectual payment, both a payor and a payee. Sometimes, of course, the law appropriates moneys in payment, or permits the creditor to do it; but that is in consequence of some express or implied understanding between the parties. In such instances an intention on the part of both parties to make payment on some indebtedness underlies what the law accomplishes, and the law is called in only because, while payment is intended, the particular item of indebt-

edness to which it shall be appropriated is not specifically point out. In no sense, however, is a deposit like the deposit here payment, or intended as payment. This is the first condition of the decision in New York Bank v. Massey and a vital one; because, if a deposit in the usual course of business may be in the nature of a payment, an unlawful preference would necessarily be involved under the circumstances of either New York Bank v. Massey or the case at bar, a suggestion of a possibility which the Supreme Court was compelled to negative.

"What the International Trust Company did in the case at bar more than what was done in New York Bank v. Massey was, as we have said, simply to give form to what the law itself accomplished in substance. *Moreover, if what was done* by the International Trust Company in distinction from what was done by the creditor in New York Bank v. Massey, *accomplished a preference, and for that reason was invalid* or had been invalidated, *the condition prior to the charging up the demand loans would have been restored by force of law, and the deposit would remain with* the International Trust Company, precisely *as it did in the case before the Supreme Court,* and also *the law would be left to operate in precisely the same manner.* All this, therefore, raises no substantial difference which we can discover to relieve us from the conclusions of the Supreme Court in the case on which the International Trust Company relies.

In addition to the above, we refer to the decision of the Circuit Court of Appeals in the Seventh Circuit in Re George M. Hill Co., 130 Fed. 315, 64 C. C. A. 561, 66 L. R. A. 68. This case was decided only a few months after New York Bank v. Massey, and at page 318 of 130 Fed., at page 564 of 64 C. C. A. (66 L. R. A. 68), it was rested thereon. In that case it appears, at page 316 of 130 Fed., at page 563

> of 64 C. C. A. (66 L. R. A. 68), that two days before the filing of the petition in bankruptcy the creditor bank appropriated the balance of the deposit account precisely as was done in the case before us. No distinction was made by the Circuit Court of Appeals on that account. It is true that the attention of the court does not seem to have been specifically called thereto; but the facts indicate that none of the parties to that litigation perceived any distinction on account thereof."

Therefore, as that Court held, if what the Bank of Alaska did by *offsetting* the deposit of the gold dust against the indebtedness of the partnership was in any way at the time improper, the result would be that *the deposit was still with the bank at the time* the petition in bankruptcy was filed, and under the Bankruptcy Act, section 68-a, the case of *a deposit* in the bank to the credit of the partnership and *an indebtedness* to the bank against the partnership *existed,* and the Bankruptcy Act itself *offsets* the deposit credit against the indebtedness to the bank, and the result is exactly what the bank itself did on July 31st, 1913, and the trustee could not recover the deposit.

VII.

THE GENERAL VERDICT IS INCONSISTENT WITH THE ANSWERS GIVEN TO THE THREE SPECIAL INTERROGATORIES, AND THE ANSWERS TO THE THREE SPECIAL INTERROGATORIES REQUIRED A JUDGMENT FOR DEFENDANT.

The jury, by their affirmative answer to the *first* special interrogatory (Tr. p. 191) found, as a matter

of fact, that the American Bank of Alaska, on the 31st of July, 1913, purchased from T. Mitchell & Co. gold dust of the value of $3,734.12, and if said gold dust was purchased from said Mitchell & Co. at that time the relation of debtor and creditor immediately arose between said copartnership and said bank, the bank being then indebted to said Mitchell & Co, for the value of said gold dust, and the evidence conclusively shows, and is not denied, that Mitchell & Co. were at said time indebted to the bank for overdrafts and the proceeds of promissory notes in a sum in excess of the value of said gold dust so purchased. Therefore, mutual debits and credits existed between the bank and Mitchell & Co., which, under the law, should have been set off as against each other in a Court of bankruptcy. If said gold dust was sold to the bank, then the gold dust itself ceased to be the property of Mitchell & Co., and they thereupon became entitled merely to a credit on their account for the value of said gold dust. All the evidence shows that the gold dust was sold to the bank before 5 o'clock in the afternoon of the 31st of July, 1913.

The jury failed to agree upon the second special interrogatory, which was as follows:

> "Were the proceeds of said purchase deposited to the general bank account of Mitchell & Co. at the time of said purchase?"

and likewise failed to agree upon an answer to the third question, which was as follows:

> "Did the defendant bank, at the time it credited said gold dust to the deposit account of Mitchell & Co., set off the amount of the overdraft due from Mitchell & Co. and their then past due note, against said deposit account?"

The jury agreed upon an answer to the fourth question (Tr. p. 191), finding affirmatively thereon. Said question was as follows:

> "Did the defendant bank, *at the time it set off* the overdraft and overdue notes *against the deposit account* of Mitchell & Co., have reasonable cause to believe that the firm of T. Mitchell & Co. was insolvent?" (Tr. p. 191).

They also found affirmatively on the fifth question (Tr. p. 192), which was as follows:

> "Did the defendant bank, *at the time it set off* the overdraft and overdue note of Mitchell & Co. *against the deposit account,* have reasonable cause to believe that, by so doing, a preference would be thereby effected?"

We there find that the jury could not agree as to whether or not the proceeds of said purchase were deposited to the account of Mitchell & Co. at the time of the purchase, when they failed to answer the second question; but by their *answer to the fourth question they find affirmatively that a set-off had taken place of the overdraft and overdue notes against the deposit account of Mitchell & Co.* Therefore they must have found that the money was placed in the deposit account of Mitchell & Co. although they tried to avoid committing themselves on this point by refusing to answer the second

interrogatory. Likewise, in question No. 4 they find that the bank did offset the overdraft and overdue notes against the deposit account of Mitchell & Co., while they try to avoid the question by refusing to answer interrogatory No. 3. The jury likewise find in their answer to the fifth question that the bank set off the overdraft and overdue notes against the deposit account of Mitchell & Co.

It is respectfully submitted that, if the gold dust was purchased on the 31st of July, 1913, by the bank from Mitchell & Co., thereupon the right of setoff immediately arose, and there could be no foundation whatsoever for a finding in favor of the plaintiff, and the question as to the time when the setoff was made or the time when the amounts were credited to Mitchell & Co. become absolutely immaterial.

If it was a purchase it was not a delivery of a commodity for the purpose of settling an indebtedness. If it was a credit in favor of Mitchell & Co. remaining in the possession of the defendant, the general law and the bankruptcy law will give the defendant the right of offsetting said credit against any account that it had against Mitchell & Co., and were this not done by the bank, the trustee in bankruptcy must of necessity, under the bankruptcy law, make the setoff himself.

There was not one particle of evidence of any description to indicate in any way that the bank had any knowledge of the insolvency of the firm of

Mitchell & Co. or that a preference would be effected by a setoff, if a preference could be treated in that connection, and we contend that it could not be, as a preference has a distinct legal meaning and does not vary the law relative to setoffs.

By their special verdict the jury found all the facts necessary to entitle them to bring in a verdict in favor of the defendant, and on the face of the two verdicts, considering them together and considering the jury's failure to decide upon the answers to special interrogatories Nos. 2 and 3 and to consider the instructions given by the Court, it is obvious that the jury desired to find in favor of the plaintiff in spite of the evidence and in spite of the instructions of the Court.

It is very evident from the verdict that the jury did not understand, or would not follow, the instructions of the Court as to the rights of the defendant regarding setoff, when they found affirmatively that the bank purchased the gold dust on the 31st of July, 1913, and then found a general verdict against the defendant.

Defendant contends that the three elements necessary to be established in order to entitle the defendant to a decree were as follows:

(1) That the gold dust was purchased from Mitchell & Co. by the defendant bank, thus creating the relation of debtor and creditor.

(2) That the money was deposited to the credit of T. Mitchell & Co.—this merely for the purpose of wiping out the overdraft.

(3) That the overdue notes were actually charged against said account.

All these facts were found by the jury in favor of the defendant, yet they brought in their general verdict in favor of the plaintiff.

It is further contended that no judgment should have been entered on the verdict of the jury so long as their affirmative answer stood to the first special interrogatory, for the other acts performed by the bank after the purchase of the gold dust were merely incidental and were not necessarily performed by the bank, and had they not been done by the bank the trustee would have been compelled to do them, under the direction of the referee in bankruptcy.

Evidence of the fact that the jury wilfully or in ignorance disregarded the instructions of the Court is found by a perusal of the 12th instruction given by the Court (Tr. pp. 179-180), wherein a preference is defined as follows:

> "A preference consists in a person (1) while insolvent, and (2) within four months of the bankruptcy, (3) procuring or making a transfer of his property, (4) the effect of which will be to enable one creditor to obtain a greater percentage of his debt than any other creditor of the same class."

In this case there was no transfer of the property of Mitchell & Co.; they sold the gold dust and it then became the property of the bank. They did not pay to the bank the money arising from the

sale of said gold dust, but it was left there in the regular course of business, and the application thereof was made by the bank for the purpose of offsetting the indebtedness of Mitchell & Co. in the due course of business and without consulting Mitchell & Co. in any way.

Furthermore, in the 14th instruction the Court instructed the jury in part as follows:

> "A deposit of money in a bank, upon an open account subject to check, is not a transfer constituting a preference, although the bank, as a creditor, has a right to set off its claims against the deposit, and the action of a bank in applying a deposit or any portion thereof upon a depositor's indebtedness to the bank does not constitute a preferential transfer, if received in good faith by the bank in due course of business; and if you find from the evidence in this case that the bankrupt sold certain gold dust to the American Bank of Alaska, in good faith and in the due course of business, with the intention that said money be placed to the bankrupt's general account in said bank, and that such deposit was so made, then I instruct you that the bank had the absolute right to set off against said deposit any overdraft due from the bankrupt and any notes then due from the bankrupt to said bank" (Tr. pp. 180-181).

The jury found, as a matter of fact, every affirmative allegation necessary to make said Instruction No. 14 directly applicable to the case at bar, and having found that the gold dust was sold to the bank, that the money was deposited to the general account of Mitchell & Co., and that the bank did set it off against the indebtedness due from said Mitchell &

Co., they clearly and unequivocally disregarded the instructions of the Court when they brought in a verdict for the plaintiff.

There is not one particle of evidence in the case of any probative force whatsoever that indicated in any way that the bank had any reason to suppose that Mitchell & Co. were insolvent, or that by setting off their claims against Mitchell & Co. against the deposit account a preference would thereby be effected; for Mitchell & Co., at the time they sold said gold dust to the bank, expected to continue with their work; the ground was looking better, and they had no idea of any trouble impending, or that they would be forced into bankruptcy; and on the contrary, referring to July 31, when Fallon was notified by the bank, by Mr. Bruning, that they could not honor any more overdrafts, Mr. Fallon testified in answer to the trustee's counsel, Mr. Pratt:

> "Q. State when it was that you notified Mr. Bruning that if the checks of that firm would not be honored that you would shut down?
> A. Well, Judge Pratt, *those words never came out of my mouth* in my testimony, about me shutting down.
> Q. Some different words then?
> A. *No, sir.*" (Tr. p. 171.)

The Court instructed the jury in the 11th instruction that:

> "A transfer can not be avoided simply on proof that the creditor had doubt or suspicion

> that a preference was intended, for it is not enough that the creditor has some cause to suspect the insolvency of the debtor, but he must have such knowledge of fact as to induce a reasonable belief of his debtor's insolvency." (Tr. pp. 178-179.)

Is there any evidence in the record of any intention on the part of Mitchell & Co. to effect a preference? On the contrary, all the evidence shows that they expected to continue to draw against the bank, thinking that they would be granted further courtesies in the way of an overdraft, and they had no idea at the time they sold the gold dust to the bank that they would not be permitted to continue to draw against the bank the same as theretofore. A bank has the absolute right to say when it shall or shall not extend credit, and its duty to its depositors and to its stockholders requires that it take every precaution to prevent loss. After the purchase of the gold dust a creditor of Mitchell & Co. attempted to attach the bank account, and had the bank thereafter permitted overdrafts it would not only have been guilty of bad management, but would probably have been criminally negligent had any loss occurred.

It is respectfully submitted, judgment for the defendant should have been given upon the jury's findings in answer to special interrogatories one and four (Tr. p. 191).

VIII.

ERRORS IN RULINGS ON THE TRIAL.

Plaintiff in error insists that the Court erred in the following rulings upon the trial, hereinbelow *numbered* to correspond to the numbers of the assignments of error (Tr. pp. 215-246):

(2) In refusing the motion of defendant for a *directed* verdict at the close of plaintiff's case (Tr. pp. 106-107).

(4) Overruling defendant's motion for a *directed* verdict at the close of defendant's case (Tr. pp. 172-173).

(8) Denying defendant's motion for a *judgment notwithstanding the verdict* (Tr. pp. 195-197).

(9) Overruling motion of defendant for a *new trial* (Tr. pp. 197-203).

(10) In entering judgment for plaintiff upon the verdict (Tr. pp. 203-204).

IX.

ERRORS IN RULINGS ADMITTING EVIDENCE ON TRIAL.

The Court erred to the prejudice and injury of defendant in its rulings *allowing* evidence on the trial, as follows:

(13) Allowing the *schedules* in the bankruptcy proceeding in evidence (Tr. pp. 28-38).

(14) Allowing in evidence the adjudication of Fallon, Fawcett and Mitchell— individuals, *not of the firm,* in evidence (Tr. pp. 38-40).

(16) and (17) Allowing in evidence and refusing to strike out trustee's bond in the bankrupt estate of Fallon, Fawcett and Mitchell, as individuals and *not* of the *firm* (Tr. pp. 43-44; 47-49).

X.

ERRORS IN INSTRUCTIONS TO THE JURY.

The Court erred to the injury and prejudice of defendant in giving the following instructions to the jury (Tr. pp. 173-183, shows the whole charge to jury):

1. The Court erred in giving to the jury instruction numbered "13", (Tr. p. 180) reading as follows:

> "If the jury finds from the evidence that on the 31st of July, 1913, the firm of T. Mitchell & Company did *not make a deposit* subject to check as hereinafter defined to you in these instructions, *but did make a payment of a past due indebtedness,* and that at that time the firm of Mitchell & Company was insolvent, and that said defendant bank had reasonable cause to believe that by accepting a payment it would secure an *unlawful preference,* and by so doing would secure a larger percentage of its debts than other creditors of the same class, then I instruct you *such a payment,* if you find it to be *a payment,* would be an *unlawful preference,* and your verdict should be for the plaintiff" (Tr. p. 180).

This instruction is absolutely contrary to the allegations of the amended complaint, which makes no claim *of payment,* but alleges *a sale* to the bank with intention that value of the gold dust *be credited* to Mitchell & Co. in their general account in the bank so they could check against it (Tr. par. VII, pp. 6-7).

This instruction is also contrary to *all* the evidence in the case on behalf of both plaintiff and defendant. There was not at any place in the trial the remotest suggestion that the gold dust was delivered or sold *as payment* or received by the bank as payment.

The Court had already, in instruction "9" (Tr. p. 177), instructed the jury that the offset by the bank of note due, was *not a transfer of property* by the bankrupt. There was never any claim of a *preference by payment;* and the result of this instruction was prejudicial and injurious to defendant.

This instruction also limits the right of the bank to set off "a deposit *subject to check",* which is not the law; it may be a deposit, not subject to check, but still subject to setoff, unless it be special creating a trust or a bailment, and such like, of which there is absolutely nothing in the pleadings or evidence in this case.

2. The Court erred in giving to the jury instruction numbered "10" (Tr. pp. 177-178) as follows:

> "The Court instructs the jury that the word 'insolvent' as used in the pleadings in this case, means that on the 31st day of July, 1913,

> the aggregate of all the property belonging to the copartnership firm of T. Mitchell & Co., and that of T. Mitchell, J. J. Fallon, and Herman Fawcett, the individuals composing such firm, was not sufficient at a fair valuation to pay the debts of such copartnership firm.
>
> The phrase 'reasonable cause to believe the transfer would effect a preference' means, as applied to the pleadings and evidence in this case, that at the time of such setoff by the defendant bank, some one or more of its officers had knowledge concerning the financial affairs of said copartnership firm of T. Mitchell & Co., sufficient to induce the belief in their minds of the insolvency of said firm, and that such setoff would effect a preference in its favor over other creditors. Actual knowledge of insolvency and that the setoff would enable the bank to get a greater percentage of its debt than other creditors of the same class might or could get, is not necessary or required under the bankruptcy law, but 'reasonable cause to believe' such insolvency and preference is all that the plaintiff is bound to establish by a preponderance of the evidence" (Tr. pp. 177-178).

This instruction attempts to *define the* meaning of *"insolvent",* and is injuriously and prejudicially incorrect, and is not the definition of "insolvent" as given in the Bankruptcy Act itself, as follows:

> "(15) A person shall be deemed *insolvent* within the provisions of this act whenever the aggregate of his property, *exclusive of any property* which he may have conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, with intent to defraud, hinder or delay his creditors, shall not, at a fair valuation, be sufficient in amount to pay his debts."
>
> Bankruptcy Act, section 1 "(15)".

Again, it tells the jury that "reasonable cause to believe the *transfer* would effect a preference" means, if *"some one or more of its officers"* had knowledge concerning the financial affairs of the *copartnership* firm of T. Mitchell & Co. sufficient to *induce* the belief in their minds of the insolvency of the firm, and that such setoff would effect a preference in its favor *over other* creditors.

"Some one or more of its officers" is not sufficient; it must be some officer *in charge of or connected with* the transaction in controversy, or *the* officer who is acting in the matter accomplished.

The word *"transfer"* is also erroneous, as there is no question of "transfer" of any property under the pleadings or evidence in this case, and the jury undoubtedly assumed the word "transfer" to refer to the *transfer of credit* on the *books* of the bank.

XII.

ERROR IN REFUSING INSTRUCTIONS REQUESTED BY DEFENDANT.

The Court erred in refusing to give *each one* of the following instructions requested by defendant and in eliminating portions given, to wit:

> "(41) The Court erred in refusing to instruct the jury and in overruling defendant's motion to give to the jury its proposed instruction as follows:
>
> A deposit consists of the delivery by any person to a bank of money, or its equivalent, for the purpose of having the same retained by said bank, with the duty on the part of the bank to

credit the person so leaving the money, or its equivalent, with said bank. Deposits may be general or special. In case of a general deposit, the moment the money is delivered to the bank it becomes the property of the bank and the relation of debtor and creditor then exists between the bank and the depositor, and the bank is thereupon liable to such person so depositing said money for the value thereof, and the person so depositing the same may withdraw the same in a variety of ways, among which is drawing checks against said deposit, which checks the bank is obliged to pay unless, among other things, it has not sufficient funds to the credit of the drawer of the check to pay the whole check, or said bank has appropriated said money for payment of a debt from the depositor to the bank, or has a lien thereon for overdue indebtedness from the depositor to the bank, and the bank is not obligated in any way to pay orders against said deposit in whatsoever form they may be presented to the net credit balance standing on the books of the bank in favor of said depositor.

(Defendant's exception No. 43.)" (Tr. pp. 236-237).

"(42) The Court erred in refusing to instruct the jury and in overruling defendant's motion to give to the jury defendant's proposed instruction as follows:

You are instructed that, if you find from the evidence in this case that the proceeds of the gold dust sold to the bank on the afternoon of 31 July, 1913, were credited to the deposit account of T. Mitchell & Co. at the time of such sale, then the bank had an absolute right to set off the indebtedness of said T. Mitchell & Co. to it against the amount thus deposited, and such setoff could be made immediately upon the ascertaining of the amount of the purchase price of said gold dust and the

crediting of the same to the deposit account of said T. Mitchell & Co., regardless of whether or not said T. Mitchell & Co. were insolvent, or whether or not, at the time of said setoff, the bank had reasonable cause to believe that said T. Mitchell & Co. were insolvent.

(Defendant's exception No. 43.)" (Tr. pp. 237-238.)

"(43) The Court erred in refusing to instruct the jury and in overruling defendant's motion to give to the jury defendant's proposed instruction as follows:

The instructions given to you relative to preference and the right of a trustee in bankruptcy to recover a preference must be taken subject to the right of the bank to set off the deposits to the credit of an insolvent person or firm against the overdraft or notes of said bank due to said bank; and, in connection with the right of setoffs, I instruct you that, in all cases of mutual debts or mutual credits betwen the estate of a bankrupt and a creditor, the account shall be stated and one debt shall be set off against the other and the balance only shall be allowed or paid.

(Defendant's exception No. 43.)" (Tr. p. 238.)

"(44) The Court erred in refusing to instruct the jury and in overruling defendant's motion to give to the jury defendant's proposed instruction as follows:

You are instructed that, if at the time of the insolvency of any person, firm, or corporation, said bankrupt has a deposit in a bank and is indebted to the bank for notes or overdrafts, the bank has an absolute right to set off the notes and overdrafts held by it against said account, and if the bank did not do so, it is the duty, under the bankruptcy law, of the referee in bankruptcy to ascertain the state of said account and to strike said balance, and

to set off said notes or overdrafts against said deposit account.

(Defendant's exception No. 43.)" (Tr. pp. 239-240.)

"(45) The Court erred in refusing to instruct the jury and in overruling defendant's motion to give to the jury defendant's proposed instruction as follows:

Money which is turned over to an officer of a bank without any request that it be kept separate from the other funds of the bank, and which is entered upon the books as a general deposit, and a certificate of deposit issued for the amount, or an entry thereof made upon the general account of such depositor, if he has an account with said bank, is a general deposit, and is not in any sense a special deposit. A deposit has been further defined as the thing or the sums received from the depositor, and a deposit in a bank is presumed to be a general deposit, in the absence of an agreement to the contrary. The purpose and terms of a deposit may be explicitly stated or the intention of the parties may be inferred from their declarations considered in connection with their conduct and all the circumstances.

(Defendant's exception No. 43.)" (Tr. p. 239.)

"(46) The Court erred in refusing to instruct the jury and in overruling the defendant's motion to give to the jury defendant's proposed instruction as follows:

I instruct you that any delivery of money by a person to a bank, to be placed to his credit, is subject to check within the meaning of said expression, unless received and accepted by said bank as a special deposit in some form, not to be drawn against by check, and the right

to check against said account is not an absolute right, even though said money is deposited subject to check, unless, after the making of said deposit, there is a credit balance in favor of said depositor, after the payment of any overdrafts that said depositor may have had and the charging against said account of any matured or overdue notes held by such bank against said depositor, and his right to draw out a sum of money equal to the amount deposited is limited by the right of the bank to set off its indebtedness against said amount so deposited, as you have been heretofore instructed.

(Defendant's exception No. 43.)" (Tr. pp. 239-240.)

"(47) The Court erred in refusing to instruct the jury and in overruling defendant's motion to give to the jury defendant's proposed instruction as follows:

You are instructed that, where a bank holds a depositor's note, it has a right, at any time during the day on which said note falls due, or thereafter, to apply funds in its hands belonging to the maker of such note to the payment thereof, even where nothing will be left to the maker's credit to apply on checks.

(Defendant's exception No. 43.)" (Tr. p. 240.)

"(48) The Court erred in refusing to instruct the jury and in overruling defendant's motion to give to the jury defendant's proposed instruction as follows:

I instruct you that the enforcement by a bank of its lien or right of set-off by applying deposits, honestly made in the due course of business and without intent on the part of the depositor to prefer the bank, to the payment of the depositor's overdrafts and his notes in

the bank's favor, as they mature, does not, although within four months of the bankruptcy proceedings against such depositor, constitute a preference forbidden by the National Bankruptcy Act, there being nothing in section 68 of said act which prevents the parties from voluntarily doing before the petition is filed what the section itself requires to be done after the proceedings in bankruptcy are instituted.

(Defendant's exception No. 43.)" (Tr. pp. 240-241.)

"(49) The Court erred in refusing to instruct the jury and in overruling defendant's motion to give to the jury defendant's proposed instruction as follows:

I instruct you that, if you are satisfied from the evidence in this case that the defendant bank made certain loans and permitted certain overdrafts to the firm of T. Mitchell & Co. between their second and third cleanups, upon the promise and agreement on the part of the said T. Mitchell & Co. that they would deliver to said defendant bank the gold dust derived from the next cleanup, to secure or pay said loans and advances, then I instruct you that the transaction should be considered as the taking of security by said bank for a present loan or consideration, and the payment of said loan and advances by the delivery of said gold dust in accordance with the agreement, if you find such agreement was had, is not such a payment as would constitute a preference in the contemplation of the National Bankruptcy Act.

(Defendant's exception No. 43.)" (Tr. pp. 241-242.)

It is respectfully submitted that each one of the foregoing instructions was proper and pertinent in

this case under the issues and evidence, and that they should have been given by the Court to the jury.

XIII.

AMENDMENT TO ANSWER REFUSED.

The Court erred in refusing the following amendment to defendant's answer (Tr. pp. 204-205):

> "(54) The Court erred in refusing, subsequent to the rendition of the verdict and prior to the argument for a judgment notwithstanding the verdict, and the motion for a new trial, to permit the defendant to amend paragraph 1 of its answer to plaintiff's amended complaint to conform to the evidence in said cause, by changing the words of the date therein when said setoff was made against said account from '1 August, 1913,' to '31 July, 1913,' and to amend paragraph 4 of its affirmative answer to conform to the evidence, by changing the words '1 August, 1913,' to '31 July, 1913,' and to amend paragraph 5 of its affirmative answer to conform to the evidence, by changing the words '1 August, 1913,' to '31 July, 1913'; all on the ground that the evidence introduced showed that the date '1 August, 1913' was erroneously given in said answer when it should have been '31 July, 1913.' (Defendant's exception No. 48.)" (Tr. pp. 204-205.)

It is respectfully submitted, the judgment and orders brought by the writ of error for review by this Court, should be reversed, with instructions to the Court below either to sustain defendant's demurrer to the amended complaint and give judgment thereon for defendant; or to enter a judg-

ment for defendant upon the special verdict, or notwithstanding the verdict.

Dated, San Francisco,
February 14, 1917.

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